

# NOTES

## LIABILITY OF RECONSIGNORS FOR FREIGHT CHARGES\*

THE Interstate Commerce Act requires carriers to collect a reasonable charge for their services without discrimination among parties to a shipment.<sup>1</sup> To prevent such discrimination,<sup>2</sup> courts have construed contracts of carriage by which liability is allocated between consignor and consignee (generally embodied in the uniform bill of lading)<sup>3</sup> so as to hold parties to a shipment strictly liable for the charges.<sup>4</sup> One result of this inflexible rule has been the imposition of absolute liability for charges upon a party who is named as consignee of a shipment, but reconsigns without accepting delivery.<sup>5</sup> Dissatisfaction with this rule has produced a bill now pending in Congress to give some relief to those *shippers* who consign to themselves and later reconsign.<sup>6</sup> The Seventh Circuit Court of Appeals, going even further than such legislation, has in a recent case established the rule that *any* reconsignor can limit his liability for freight charges.<sup>7</sup>

In this case a shipper had consigned several carloads of oil via the plaintiff carrier, naming the defendant as consignee. While the shipment was still in transit the defendant instructed the carrier to deliver to a consignee, but to collect freight before delivery.<sup>8</sup> Contrary to these instructions, a forty-eight

---

\* New York Central R. R. v. Transamerican Petroleum Corp., 103 F. (2d) 994 (C. C. A. 7th, 1940).

1. 24 STAT. 380 (1887), 49 U. S. C. §3(1) (1934); 34 STAT. 586 (1906), 49 U. S. C. §6(7) (1934).

2. See Louisville & N. R. R. v. Central Iron & Coal Co., 265 U. S. 59 (1924); Pittsburgh, C., C. & St. L. Ry. v. Fink, 250 U. S. 577 (1919).

3. In the Matter of Bills of Lading, 52 I. C. C. 671 (1919), 64 I. C. C. 357 (1921). See 4 WILLISTON, CONTRACTS (rev. ed. 1936) §§1073, 1081; ELLIOTT, BAILMENTS (2d ed. 1929) §207.

4. New York C. H. R. R. v. York & Whitney Co., 256 U. S. 406 (1921); Pittsburgh, C., C. & St. L. Ry. v. Fink, 250 U. S. 577 (1919) (consignee); New York C. R. R. v. Union Oil Co., 53 F. (2d) 1066 (W. D. Pa. 1931) (consignor); New York C. R. R. v. Warren Ross Lumber Co., 234 N. Y. 261, 137 N. E. 324 (1922) (reconsignor). The so-called Newton Amendment [44 STAT. 1447 (1927), 49 U. S. C. §3(2) (1934)] relieved from liability for freight charges those consignees who were agents only and not beneficial owners of the shipment.

5. New York C. R. R. v. Warren Ross Lumber Co., 234 N. Y. 261, 137 N. E. 324 (1922).

6. The Buck Bill, H. R. 5726, is designed to relieve from liability those shippers who consign to themselves later to reconsign where instructions to the carrier to collect before delivery are disobeyed. *Hearings before a Subcommittee of the Committee on Interstate & Foreign Commerce on H. R. 5726*, 76th Cong., 1st Sess. (1939) (hereafter cited as *Hearings*).

7. New York Central R. R. v. Transamerican Petroleum Corp., 103 F. (2d) 994 (C. C. A. 7th, 1940).

8. The reconsignment order was merely: "On arrival and without extra expense to us, please deliver these cars to the Independents Company." The court suggested that

hour credit was allowed the reconsignee,<sup>9</sup> who became bankrupt in the interim and defaulted on the payment of the freight charge. Since the shipper was free from liability by virtue of the "no-recourse" clause in the bill of lading,<sup>10</sup> suit was brought against the reconsignor for the charges. The court, in holding for the defendant, ruled that the act of reconsignment was not such an act of dominion or ownership over the shipment as would constitute an implied acceptance by the consignee of the bill of lading provisions that he would pay the freight charges. The court further held that the failure to collect from the ultimate consignee breached a contractual obligation assumed by the carrier when it undertook to carry out the reconsigning instruction. Thus the court repudiated the established rule that the reconsignor is liable for charges despite instructions to collect before delivery.

The established rule was originally set forth in *New York Central R. R. v. Warren Ross Lumber Company*.<sup>11</sup> This and the many cases which followed it imposed liability upon the reconsignor on the ground that reconsignment was an act of dominion which raised, for all practical purposes, an irrebuttable presumption that the reconsignor was the "beneficial owner" of the shipment.<sup>12</sup> The reconsignor can be considered in his dual capacity: as consignee named in the bill of lading, and as a shipper who ordered services from the carrier.<sup>13</sup> A consignee is liable for freight charges on the presumption that the shipment is made on his order and for his benefit as indicated by an act of ownership and dominion—for example, acceptance of delivery.<sup>14</sup> The reconsignor was

---

there was some room for doubt as to whether the reconsignment order included a direction to collect freight. But since it was so construed by the parties, the court acquiesced in their interpretation. *New York C. R. R. v. Transamerican Petroleum Corp.*, 108 F. (2d) 994, 996 (C. C. A. 7th, 1940).

9. Although the Transportation Act of 1920 [41 STAT. 479 (1920), 49 U. S. C. § 3(2) (1934)] forbids the extension of credit except in extraordinary situations, the Interstate Commerce Commission has made allowance for liberal credit to a carrier's customers who are on the carrier's credit list. *Ex parte* 73, 171 I. C. C. 268 (1930). See Lowden v. Iroquois Coal Co., 18 F. Supp. 923, 924 (N. D. Ill. 1935).

10. See *In the Matter of Bills of Lading*, 52 I. C. C. 671, 740 (1919).

11. 234 N. Y. 261, 137 N. E. 324 (1922).

12. A previous decision in the Seventh Circuit, *Wabash R. R. v. Horn*, 40 F. (2d) 905 (C. C. A. 7th, 1930), followed the *Ross* case, as have most courts. See cases collected in Notes 105 A. L. R. 1216 (1936), 78 A. L. R. 926 (1932), 24 A. L. R. 1163 (1923). See also *Pennsylvania R. R. v. Seiter*, 61 Ohio App. 497, 22 N. E. (2d) 843 (1939), (1940) 38 MICH. L. REV. 895; *New York C. R. R. v. Stanziale*, 105 N. J. L. 593, 147 Atl. 457 (1929), (1930) 28 MICH. L. REV. 910.

13. Courts have usually discussed the reconsignor's liability in general terms without explicitly analyzing his dual capacity. For a discussion of the liability of consignors and consignees generally, see Watkins, *Liability of Consignors and Consignees of Interstate Shipments for Unpaid Freight Charges* (1921) 6 MINN. L. REV. 23, Comment (1935) 45 YALE L. J. 142.

14. *Union P. R. R. v. American Smelting & Refining Co.*, 202 Fed. 720 (C. C. A. 8th, 1912); *Pennsylvania R. R. v. United Collieries*, 59 Ohio App. 540, 18 N. E. (2d) 1000 (1938). Even where the consignee is not the "beneficial owner" of the shipment, the surrender by the carrier of its lien on the shipment is said to operate as consideration for an implied undertaking to pay the charges. *Pittsburgh C., C. & St. L. R. R. v. Fink*, 250 U. S. 577 (1919).

held liable as consignee because of a similar act of ownership and dominion — reconsigning.<sup>15</sup>

The reconsignor was also held liable to the carrier in his capacity as shipper. Ordinarily a shipper is liable for freight charges as the party on whose behalf and under whose direction the shipment is made.<sup>16</sup> A shipper can, however, by means of the "no-recourse" clause in the uniform bill of lading, relieve himself of liability where the carrier delivers without collecting charges.<sup>17</sup> But no such bill of lading provision was made available to the reconsignor.<sup>18</sup> A shipper has also been said to be free to limit his liability by contract, but contracts arising outside the bill of lading have seldom been recognized.<sup>19</sup> Therefore most courts, in determining reconsignors' liability, refused to acknowledge that a carrier, accepting a reconsignment order with instructions to collect before delivery, assumed an implied contract obligation to follow these instructions.<sup>20</sup> Even where it was conceded that an implied obligation might arise from the carrier's undertaking, such a contract was rendered ineffectual. Since a carrier cannot be estopped by its own negligence, breach of contract or violation of instructions from collecting full freight charges from any party liable,<sup>21</sup> a reconsignor was denied the defenses of estoppel<sup>22</sup> and set-off<sup>23</sup> against the carrier's claim for freight charges. Thus all efforts of the reconsignor to limit his liability as shipper were unsuccessful.

The decision of the principal case, repudiating these doctrines, was apparently prompted by the harsh results of cases adopting the *Ross* rationale.<sup>24</sup>

15. See cases cited in Note 12 *supra*.

16. *Louisville & N. R. R. v. Central Coal & Iron Co.*, 265 U. S. 59 (1924).

17. See note 10 *supra*.

18. When the uniform bill of lading was adopted, the Interstate Commerce Commission expressly refused to provide a "no-recourse" blank for shippers who reconsign. In the Matter of Bill of Lading, 52 I. C. C. 671 (1919). Nor was any blank provided for ordinary reconsignment. See note 37 *infra*; *Pennsylvania R. R. v. United Collieries*, 59 Ohio App. 540, 18 N. E. (2d) 1000 (1938).

19. See, for example, *Moss Lumber Co. v. Michigan C. R. R.*, 219 Ala. 593, 123 So. 90 (1929); *cf. Galveston, H. & S. A. Ry. v. American Salvage & Supply Co.*, 19 S. W. (2d) 25 (Tex. Civ. App. 1929); *Lowden v. Iroquois Coal Co.*, 18 F. Supp. 923 (N. D. Ill. 1937).

20. The reconsigning instruction "freight charges to follow; owner or consignee to pay charges," or equivalent language has been uniformly interpreted to constitute, not an offer to the carrier, but rather a grant of an option under which the carrier is privileged to collect before delivery. *Ex parte* 73, 171 I. C. C. 268 (1931); see cases collected in Comment (1935) 45 YALE L. J. 142, 147, n. 28.

21. See *Louisville & N. R. R. v. Central Iron & Coal Co.*, 265 U. S. 59, 65 (1924).

22. *Pittsburgh C., C. & St. L. Ry. v. Fink*, 250 U. S. 577 (1919).

23. *New York, N. H. & H. R. R. v. California Fruit Growers Exchange*, 125 Conn. 241, 5 A. (2d) 353 (1939), *cert. denied*, 60 Sup. Ct. 79 (U. S. 1939); *Pennsylvania R. R. v. Marcelletti*, 256 Mich. 411, 240 N. W. 4 (1932).

24. Courts have often admitted that the decisions imposing strict liability upon reconsignors were harsh and inequitable, but have contended that such decisions were dictated by necessity for a strict rule to prevent discrimination. See *Central Warehouse v. Chicago R. I. & P. Ry.*, 20 F. (2d) 828, 829 (C. C. A. 8th, 1927), *aff'd* 14 F. (2d) 123, 124 (D. Minn. 1926); *Western & A. R. R. v. Underwood*, 281 Fed. 891, 893 (N. D. Ga. 1922). See also *Baldwin v. Scott County Milling Co.*, 307 U. S. 478, 485 (1939).

Time and again clear instructions to collect before delivery have been disregarded by carriers who chose to extend credit to near-insolvents. Yet the risk of loss resulting from such unauthorized extension of credit did not fall upon the carrier, but upon the reconsignor. This inequity was aggravated by the reconsignors' common practice of collecting the sales price less freight by order bill of lading, relying upon the carrier to collect the freight.<sup>25</sup> Thus failure of the carrier to collect on delivery before the insolvency of the deliverer imposed upon the reconsignor a double freight charge burden.<sup>26</sup> The rule was particularly harsh for reconsignors who, although only commission agents with a small and fleeting interest in shipments which they never owned, were often held for the underpayments and defaults of reconsignees to whom credit had been extended contrary to instructions.<sup>27</sup>

The *Ross* rule imposed an equally harsh burden upon the producer of perishables who shipped "open"—naming himself or his agent as consignee—and subsequently diverted the shipment to a buyer found while the shipment was still in transit.<sup>28</sup> The efforts of "open" shippers to protect themselves against a carrier's violation of instructions to deliver collect were consistently frustrated. Those who left the "no-recourse" clause unsigned were held liable like any shipper whose consignee defaults.<sup>29</sup> But even those who did sign and, in addition, reconsigned with instructions to collect before delivery, were nonetheless liable in the role of reconsignor.<sup>30</sup>

Courts adhering to the *Ross* rule found justification for these inequities in the necessity for a strict rule to prevent discrimination.<sup>31</sup> This is not convincing, however, because under the *Ross* rule the carrier had an opportunity to discriminate by exercising his choice to collect freight charges from either reconsignor or reconsignee. The principal case, on the other hand, seems to foreclose any opportunity to discriminate because the carrier's only choice is to release the reconsignor from liability by delivering to the reconsignee without collecting; thereupon, the reconsignee automatically assumes responsibility for the freight charges by accepting delivery.<sup>32</sup> Furthermore,

25. *New York C. R. R. v. Philadelphia & R. Coal and Iron Co.*, 286 Ill. 267, 268, 121 N. E. 581, 582 (1918); *Hearings* p. 7.

26. *Hearings* p. 7.

27. The Newton Amendment, note 4 *supra*, has been construed so as not to relieve from freight charge liability those reconsignors who are not "beneficial owners" of the shipment, but rather agents of the owners. *Pennsylvania R. R. v. Lord & Spencer*, 295 Mass. 179, 3 N. E. (2d) 231 (1936); *Pennsylvania R. R. v. Rothstein*, 109 Pa. Super. Ct. 96, 165 Atl. 752 (1933), 116 Pa. Super. Ct. 156, 176 Atl. 861 (1935).

28. *New York, N. H. & H. R. R. v. California Fruit Growers Exchange*, 125 Conn. 241, 5 A. (2d) 353 (1939), *cert. denied*, 60 Sup. Ct. 79 (U. S. 1939); *New York Central R. R. v. Frank H. Buck Co.*, 2 Cal. (2d) 384, 41 P. (2d) 547 (1935); *Eric R. R. v. H. Rosenstein*, 249 N. Y. 241, 164 N. E. 37 (1928), (1928) 37 YALE L. J. 989, (1929) 29 COL. L. REV. 521.

29. *New York C. R. R. v. Philadelphia & R. Coal and Iron Co.*, 286 Ill. 267, 121 N. E. 581 (1918).

30. *New York C. R. R. v. Little-Jones Coal Co.*, 25 F. Supp. 337 (N. D. Ill. 1938).

31. See note 24 *supra*.

32. See page 1458 *supra*. These considerations are similarly applicable to ultimate consignees, sometimes termed reconsignees.

the power which the carrier possessed under the *Ross* rule to protect favored customers or to injure the unfavored by unrestricted dispensation of their credit, would seem to be removed. Lastly, a substantial discrimination in the availability of the "no-recourse" privilege to shippers who consign "open" and to shippers who consign directly seems to be eliminated.<sup>33</sup>

In adopting a rule that eliminates the inequities of the *Ross* rule without permitting discrimination, the court in the principal case utilized conceptual devices which are not novel,<sup>34</sup> and which are certainly as plausible as the logic of the *Ross* rule. The instruction to collect before delivery was interpreted as a manifestation which rebutted the presumption of ownership and liability raised by a bare reconsigning. It was further held that a reconsignment with directions to collect before delivery was not the absolute acceptance of liability from which there was no escape by contract or by estoppel of the carrier, but was rather a conditional acceptance—conditional upon the carrier's execution of instructions. To implement this conditional acceptance the court constructed an implied reconsignment contract. Where other courts had found only implied contracts which imposed liability for freight charges, this court found an implied contract which limits and conditions liability.

A possible criticism of the decision is that, by recognizing manifestations which are not operative to condition a shipper's liability, it conveys to the reconsignor a privilege greater than that of shippers who sign the "no-recourse" clause.<sup>35</sup> When a shipper signs a bill of lading, however, he expressly contracts to assume liability. At the same time, the "no-recourse" clause is available to him to make a clear demonstration of an intention to limit that liability. There is little reason, therefore, to give weight to any other manifestation of intention. On the other hand, since no express instrument is signed by the reconsignor,<sup>36</sup> a lesser manifestation of condition must be recognized in order to give the reconsignor the equivalent of a "no-recourse" clause.

Another objection to the decision might be that it imposes upon the carrier a risk of the reconsignor's business.<sup>37</sup> But the carrier has ample opportunity

---

33. See page 1460 *supra*.

34. See 2 HUTCHISON ON CARRIERS (3d ed. 1906) § 808; ELLIOTT, BAILMENTS (2d ed. 1929) § 207, 4 ELLIOTT ON RAILROADS (3d ed. 1926) § 873. *Chesapeake & O. Ry. v. Southern Coal, Coke & Mining Co.*, 254 Ill. App. 238 (1929), *cert. denied*, 282 U. S. 860 (1930); *Wallingford v. Buck*, 255 Fed. 949 (C. C. A. 8th, 1918); *Pere Marquette R. R. v. American Coal & Supply Co.*, 239 Ill. App. 139 (1929); *Erie R. R. v. Price*, 11 Ohio L. Abs. 656 (1931).

35. It has been readily conceded that such a manifestation might be made operative. *New York C. R. R. v. Warren Ross Lumber Co.*, 234 N. Y. 261, 262, 137 N. E. 324, 325 (1922); *Pennsylvania R. R. v. United Collieries*, 59 Ohio App. 540, 544, 18 N. E. (2d) 1000, 1001 (1930). This court disagrees with others only in that it gives effect to the indicia here presented. See notes 8 and 20 *supra*.

36. See page 1459 *supra*.

37. Provision for a "no-recourse" blank for shippers who reconsign was originally denied by the Interstate Commerce Commission on the ground that such a privilege would force the carrier "to assume risks for the convenience of the consignor which would have no direct relationship to its service of transportation." In the *Matter of the Bills of Lading*, 52 I. C. C. 671, 722 (1919). But apparently the Commission no longer maintains this view. See letter from Interstate Commerce Commission, *Hearings* p. 4.

to protect itself. It is privileged to demand pre-payment of the charge from the reconsignor.<sup>38</sup> If the carrier does not demand pre-payment, its lien upon the shipment is not surrendered by reconsignment, but is retained until delivery. In such a case, the carrier is not only privileged but requested to collect before delivery and surrender of the lien. If the consignee refuses to pay or to accept delivery, the carrier has recourse against the reconsignor, if not against the original shipper.<sup>39</sup> Even where the delivery is made on credit, collection can and must be made by the carrier from the accepting consignee.<sup>40</sup> Furthermore, a carrier could readily require bond from deliverers where, contrary to instructions, the carrier persists in making delivery without collection.

The court in the principal case, by extending protection to the reconsignor, has reached an equitable solution to the problem of allocating liability for freight charges. Two problems are left, however, by the new rule. In the first place, liability must be determined by the manifestation of intention as indicated by instructions from the reconsignor to the carrier. This may well leave uncertainty among carriers and reconsignors as to what manifestation is sufficient to limit the liability of the reconsignor. A solution of this problem could probably be provided by a ruling of the Interstate Commerce Commission adopting a uniform reconsignment order with a "no-recourse" clause.<sup>41</sup> In the second place, there still remains a conflict among jurisdictions which runs counter to the policy of uniformity in the regulation of interstate carriers. Solution of this problem would seem to require either a decision of the Supreme Court resolving the present conflict,<sup>42</sup> or an act of Congress which would permit reconsignors to limit their liability.<sup>43</sup>

---

38. See *Louisville & N. R. R. v. Central Iron & Coal Co.*, 265 U. S. 59, 66 (1924); *Wadley S. Ry. v. Georgia*, 235 U. S. 651, 656 (1915).

39. The language of the principal case might permit the argument that the reconsignor never assumes liability, and therefore is free from liability even where the consignee refuses to accept delivery. But the implied contract which the court constructs from the reconsigning order would seem adequate to hold the reconsignor where the carrier attempts to obey the reconsigning instructions, and is frustrated by the refusal of the consignee to accept delivery. It should also be noted that the original shipper may well be subject at least to secondary liability in such a case despite his signing of the "no-recourse" clause. See p. 1460 *supra*. But cf. *Louisville & N. R. R. v. Central Iron & Coal Co.*, 265 U. S. 59 (1924).

40. See notes 1, 14 and 20 *supra*.

41. The Interstate Commerce Commission would seem to have authority to make available a reconsigning blank. See *In the Matter of Bills of Lading*, 52 I. C. C. 671, 686 (1919); *Missouri P. R. R. v. Porter*, 273 U. S. 341, 345 (1926).

42. There is no indication that the Supreme Court will resolve the conflict very soon, for certiorari has been denied in cases representing both rules: *New York, N. H. & H. R. R. v. California Fruit Growers Exchange*, 125 Conn. 241, 5 A. (2d) 353 (1939), *cert. denied*, 60 Sup. Ct. 79 (U. S. 1939) (follows the *Ross* case); *Chesapeake & O. Ry. v. Southern Coal, Coke and Mining Co.*, 254 Ill. App. 238 (1929), *cert. denied*, 282 U. S. 860 (1930) (does not impose liability upon a reconsignor).

43. This would involve an extension of the Buck Bill [note 6 *supra*] so as to apply not only to shippers who consign to themselves and later reconsign, but to all reconsignors.

## SUPREME COURT DISPOSITION OF STATE DECISIONS INVOLVING NON-FEDERAL QUESTIONS\*

THE appellate jurisdiction of the Supreme Court over decisions of state courts has been consistently limited to questions arising under the Constitution, laws or treaties of the United States.<sup>1</sup> Non-federal matters may not be assigned as error in such appeals, even if they arise in the same case with federal questions. As a practical corollary, where the state decision is deemed to rest upon a non-federal ground, independent and adequate of itself to support the judgment, the Supreme Court will normally decline to review at all. In such a case it is thought that reversal for error in the decision of any federal questions involved would be "useless and profitless,"<sup>2</sup> since the state court could thereafter enter the same judgment upon the non-federal ground alone.

While the rule limiting the Court to review of federal questions is grounded upon basic requirements of a dual government, its corollary partakes of no such sanctity. It was originated by the Court simply as a convenient canon of self-limitation.<sup>3</sup> In most cases the practice makes for justice and efficiency. Cases where the state decision has coupled a gratuitous ruling under the federal constitution with the construction of a state statute, of some matter of procedure or of a common-law principle which supports the judgment quite independently of the federal question,<sup>4</sup> are adequately disposed of upon the non-federal ground rule, without decision of the federal question.

Until recent years, this practice has been considered discretionary rather than mandatory. The leading and most frequently cited case in the field, after a lengthy survey, originally established the unqualified proposition that *every* federal question of importance actually decided by the state court should be reviewed and decided by the Supreme Court.<sup>5</sup> Only if the federal question were incorrectly decided below — and obviously this presupposed an

---

\* *Minnesota v. National Tea Co.*, 60 Sup. Ct. 676 (U. S. 1940).

1. Section 25 of the original Judiciary Act specifically so provided: "But no other error shall be assigned or regarded as ground for reversal in any such case as aforesaid than such as appears on the face of the record, and immediately respects the before mentioned questions of validity or construction of the said [Federal] constitution, treaties, statutes, commissions, or authorities in dispute." 1 STAT. 85 (1789). This section has been omitted from all subsequent Judiciary Acts [14 STAT. 385 (1867), 28 U. S. C. § 344 (1934)] but its substance has been continued by judicial construction. *Murdock v. Memphis*, 20 Wall. 590 (U. S. 1874).

2. ROBERTSON AND KIRKHAM, JURISDICTION OF THE SUPREME COURT (1936) § 84.

3. *Murdock v. Memphis*, 20 Wall. (U. S. 1874) 590. At that time the Judiciary Act permitted review only when the federal claim had been denied, but that limitation does not affect the application of the non-federal ground rule. 14 STAT. 385 (1867).

4. *Hallanan v. Eureka Pipe Line Co.*, 261 U. S. 393 (1923) (separability of state-statute); *New York ex rel. Doyle v. Atwell*, 261 U. S. 590 (1923) (effect of writ of habeas corpus); *Uiley v. St. Petersburg*, 292 U. S. 106 (1934) (estoppel). For an extreme case, see *Quong Ham Wah Co. v. Industrial Comm.*, 255 U. S. 445 (1921). Cf. *Fox Film Co. v. Muller*, 296 U. S. 207 (1935) (contract violating Sherman Act and common law).

5. *Murdock v. Memphis*, 20 Wall. 590 (U. S. 1874).

examination of the merits — would the Court look for an independent non-federal ground adequate to support the judgment and prevent reversal in spite of the federal error.<sup>6</sup> Under this view the non-federal ground concept was used as a test for determining the disposition of a case after jurisdiction had been taken rather than as a test of jurisdiction itself. The presence of a non-federal question might require affirmance of a judgment containing federal error, but would not bar the assumption of jurisdiction to expose and correct that error. Gradually, for reasons of dispatch and convenience, it became customary for the Supreme Court, in cases involving non-federal questions, to dismiss the appeal instead of affirming the state judgment.<sup>7</sup> And since the adoption of Supreme Court Rule 12,<sup>8</sup> under which the appellant is required to submit a jurisdictional statement prior to oral argument, this practice has become uniform. Consequently, the Supreme Court today rarely allows appeals containing non-federal questions to reach the stage of argument upon the merits.<sup>9</sup>

If the non-federal ground rule could be applied to varying factual situations as automatically as it is invoked by the Court to dispose of them, no great problems would arise. But the rule is complicated by the existence of three well-recognized though ill-defined exceptions. Where the non-federal ground is "interwoven" with the federal ground,<sup>10</sup> where it is unsubstantial<sup>11</sup> or untenable,<sup>12</sup> or where the non-federal ground, though present, was not actually decided by the state court<sup>13</sup> the Supreme Court will review. What actually suffices to bring a case within each of these exceptions is a difficult problem.

One situation which the Supreme Court has failed to recognize as an exception to the non-federal ground rule, and which causes great logical and practical difficulty, is that created when a state court construes identical provisions of the state and federal constitutions upon the exclusive authority of federal cases. Technically, of course, the state and federal grounds in such a situation are completely independent, since the state court is the final

---

6. *Id.* at 636 (proposition No. 6).

7. Typical of the opinions before 1928 is the following: "In cases where the state court has decided a local question adequate to support its judgment this court has sometimes affirmed and sometimes dismissed the writ of error [cases]. We have again considered the matter and have concluded that, *generally at least*, it is better practice to dismiss." [Italics added]. *Live Oak Water Users' Ass'n v. Railroad Comm.*, 269 U. S. 354, 359 (1926); see *Southern Pac. Co. v. Schuyler*, 227 U. S. 601, 610 (1913). *Contra*: *Howat v. Kansas*, 258 U. S. 181 (1922).

8. 275 U. S. 603 (1928), 28 U. S. C. A. following § 354 (Supp. 1940).

9. Frankfurter and Fisher, *Business of Supreme Court—1935 and 1936 Terms*, 51 HARV. L. REV. 577, 581, *et seq.*

10. *Abie State Bank v. Bryan*, 282 U. S. 765 (1931); see *Enterprise Irrig. Dist. v. Farmers' Mut. Canal Co.*, 243 U. S. 157, 164 (1917).

11. *Lawrence v. State Tax Comm.*, 286 U. S. 276 (1932).

12. *Ward v. Love County Bd. of Comm'rs*, 253 U. S. 17 (1920). The Supreme Court has not allowed states to put unreasonable procedural obstacles in the way of a suitor claiming a federal right. *Davis v. Wechsler*, 263 U. S. 22 (1923).

13. *Grayson v. Harris*, 267 U. S. 352 (1925); *State of Indiana ex rel. Anderson v. Brand*, 303 U. S. 95 (1938); *Virginia v. Imperial Coal Sales Co.*, 293 U. S. 15 (1934).



authority upon the construction of its own constitution and may properly give to certain words a meaning at variance with that attached to the same words in the Federal Constitution by the Supreme Court.<sup>14</sup> But frequently it seems that the state court reasons from the major premise of the federal cases and the minor premise of the identity between the provisions of both constitutions, to an interpretation of the state constitution which is obviously not "independent."<sup>15</sup>

Where this sort of interdependence between the state and federal grounds appears in the state decision, an automatic application of the non-federal ground rule which forecloses review by the Supreme Court is highly unsatisfactory. For example, in *Lynch v. New York ex rel. Pierson*, the Appellate Division of the New York Supreme Court had annulled a tax assessment for violation of due process,<sup>16</sup> citing eight Supreme Court cases on the Fourteenth Amendment. The Court of Appeals affirmed without opinion,<sup>17</sup> and the Supreme Court, after granting certiorari for importance, dismissed the writ as improvidently granted, saying that its jurisdiction could not be founded upon the "surmise" that the state decision rested upon the federal ground rather than upon the due process clause of the state constitution.<sup>18</sup> In *New York City v. Central Savings Bank*,<sup>19</sup> the amended remittitur of the New York court even more clearly indicated that its decision was based primarily, if not wholly, upon the federal question: "Our conclusion that the statute is repugnant to Art. I, Sec. 6 of the state constitution *followed necessarily* from our determination that, in accordance with a long line of decisions of the Supreme Court of the United States, the statute is repugnant to the Federal Constitution."<sup>20</sup> But the Supreme Court declined, upon the authority of cases stating the non-federal ground rule, to issue a writ of certiorari.<sup>21</sup>

A recent case<sup>22</sup> illustrates a novel variation upon this theme. The Minnesota Supreme Court held the Minnesota graduated gross sales tax<sup>23</sup> on chain stores invalid under the equal protection clause of the Fourteenth Amendment and the uniformity clause of the state constitution,<sup>24</sup> which, it said,

14. The same is true of federal and state statutes. *Cf.* *Detroit & Mackinac Ry. v. Paper Co.*, 248 U. S. 30, 31 (1918).

15. *New York City v. Central Savings Bank*, 280 N. Y. 9, 19 N. E. (2d) 659 (1939); see note 20 and accompanying text *infra*.

16. 237 App. Div. 763, 263 N. Y. Supp. 259 (3d Dep't 1933).

17. 263 N. Y. 533, 189 N. E. 684 (1933).

18. 293 U. S. 52 (1934).

19. 306 U. S. 661 (1939).

20. [*Italics added.*] 280 N. Y. 9, 19 N. E. (2d) 659 (1939).

21. The case of *Morehead v. New York ex rel. Tipaldo*, 298 U. S. 587 (1936) is apparently inconsistent with the *Lynch* and *Central Savings* cases. Although the New York Court of Appeals had explicitly declared a statute invalid under both due process clauses, the Supreme Court took jurisdiction to review, possibly because the respondent did not contest jurisdiction and because the *sole* authority for the New York decision was a controversial Supreme Court case.

22. *Minnesota v. National Tea Co.*, 60 Sup. Ct. 676 (U. S. 1940).

23. Minn. Laws 1933, c. 213. The gross sales feature of the tax was suspended for four years in 1937. MINN. STAT. (Mason, Supp. 1940) §§ 5887-1 to 5887-18.

24. MINN. CONST. Art. 9, § 1.

imposed "identical restrictions" upon the legislative power of the state with respect to tax classification.<sup>25</sup> After brief mention of three Minnesota decisions broadly interpreting the uniformity clause,<sup>26</sup> the court declared that the precise question had been directly passed on in five cases,<sup>27</sup> "which it is our duty to follow."<sup>28</sup> Two of these were Supreme Court cases and all were concerned solely with the Fourteenth Amendment. The syllabus prepared by the court declared the tax invalid under both constitutions. Reviewing on certiorari, and disregarding this syllabus,<sup>29</sup> the Supreme Court expressed doubt as to the precise grounds for the state decision, intimating its belief that "the federal constitution as judicially construed controlled the decision." It vacated the judgment and remanded the cause to the Minnesota court for further proceedings to remove "obscurities and ambiguities." Three Justices dissented, stating that there was an independent non-federal ground requiring dismissal of the writ upon the authority of the *Central Savings* case.<sup>30</sup>

Although the attempt of the majority to distinguish the *Central Savings* case was thoroughly unconvincing,<sup>31</sup> there is authority for the procedure of vacating and remanding in analogous situations. It has been done where there were supervening changes of law<sup>32</sup> or of fact<sup>33</sup> before argument on appeal, where the precise nature of the asserted federal claim was uncertain,<sup>34</sup>

25. *National Tea Co. v. State*, 205 Minn. 443, 447, 286 N. W. 360, 362 (1939); see *Lake Superior Consol. Iron Mines v. Lord*, 271 U. S. 577, 581 (1926); *Reed v. Bjornson*, 191 Minn. 254, 260, 253 N. W. 102, 105 (1934).

26. *State v. Minnesota Farmers' Mut. Ins. Co.*, 145 Minn. 231, 176 N. W. 756 (1920); *State ex rel. Mudeking v. Parr*, 109 Minn. 147, 123 N. W. 408 (1909); *In re Improvement of Third St.*, 185 Minn. 170, 240 N. W. 355 (1932).

27. *Stewart Dry Goods Co. v. Lewis*, 294 U. S. 550 (1935); *Great A. & P. Tea Co. v. Valentine*, 12 F. Supp. 760 (S. D. Iowa 1935), *aff'd per curiam*, 299 U. S. 32 (1936); *Ed. Schuster & Co. v. Henry*, 218 Wis. 506, 261 N. W. 20, *cert. denied*, 296 U. S. 625 (1935); *Lane Drug Stores, Inc. v. Lee*, 11 F. Supp. 672 (N. D. Fla. 1935); *Great A. & P. Tea Co. v. Harvey*, 107 Vt. 215, 177 Atl. 423 (1935).

28. *National Tea Co. v. State*, 205 Minn. 443, 451, 286 N. W. 360, 364 (1939).

29. By statute the Minnesota Court is required to prepare the syllabus [MINN. STAT. (Mason 1927) § 134], but it does not become, as in some other states, the law of the case. *Cf. State v. Hauser*, 101 Ohio St. 404, 407, 131 N. E. 66, 67 (1920). The Supreme Court is reluctant to look outside the official state opinion for the establishment of jurisdictional facts. See *Honeyman v. Hanan*, 300 U. S. 14, 20-21 (1937) (certificate by state judge); *Live Oak Water Users' Ass'n v. Railroad Comm.*, 269 U. S. 354, 357-359 (1926) (briefs and oral argument); *cf. Whitney v. California*, 274 U. S. 357, 360-362 (1927) (certificate signed by all state judges becomes part of record).

30. *Minnesota v. National Tea Co.*, 60 Sup. Ct. 676, 680 (U. S. 1940).

31. *Id.* at 679. Mr. Justice Douglas cited *Ives v. South Buffalo Ry. Co.*, 201 N. Y. 271, 317, 94 N. E. 431, 448 (1911) for the proposition that New York prefers its own interpretation of due process. He might have cited *Reed v. Bjornson*, 191 Minn. 254, 260, 253 N. W. 102, 105 (1934) for the same proposition in Minnesota. Such general acknowledgements of a technical rule *permitting* state and federal laws to be interpreted independently should not constitute a jurisdictional bar to Supreme Court review in cases where they are *not* interpreted independently. The *Central Savings* case itself contains language directly contradicting the *Ives* dictum. See text accompanying note 20 *supra*.

32. *Gulf, Colorado Ry. v. Dennis*, 224 U. S. 503 (1912).

33. *Pagel v. MacLean*, 283 U. S. 266 (1931).

34. *Honeyman v. Hanan*, 300 U. S. 14 (1937).

where the record did not adequately show the facts underlying the state decision,<sup>35</sup> and even where, without any strictly technical justification, the Court invoked its general power to "make such disposition of the case as justice requires."<sup>36</sup> Procedurally the disposition of the *National Tea* case is justifiable.<sup>37</sup>

The professed aim of the decision, however, was to ensure that "the responsibility for striking down or upholding state legislation be fairly placed"<sup>38</sup> (*i.e.*, on the state court or the Supreme Court). Considerations of policy in a federated nation would seem to require either that identical clauses in federal and state constitutions be interpreted harmoniously, following the persuasion of the Supreme Court, or that a sharply visible line of distinction be drawn between different interpretations where harmony is impossible. But in this case the procedure of vacation and remand without decision of the federal question served merely to divide the responsibility, to deny the Supreme Court's opportunity for leadership, and to blur a possible distinction between state and federal interpretations of "equal protection" in taxation. It has thrown back to the Minnesota court an impossible hypothetical question: would an unspecified change in the federal decisions under the Fourteenth Amendment alter that court's decision under the uniformity clause?

In the absence of any Supreme Court ruling upon the federal question, the Minnesota court may now, upon remand, do any one of several things.<sup>39</sup> It may invalidate the tax again solely upon the state constitution or other non-federal ground, foreclosing further review.<sup>40</sup> It may erase the state constitutional question entirely from its opinion, preferring to rest wholly upon the equal protection clause of the Fourteenth Amendment.<sup>41</sup> A third possibility is an honest reaffirmance upon both state and federal grounds, using the same federal authorities. But this would merely re-create the identical problem upon a second application to the Supreme Court. There would still be the suspicion that federal cases of rather doubtful present-day validity controlled the judgment, not technically as a matter of power, but actually

35. *Villa v. Van Schaick*, 299 U. S. 152 (1936).

36. *Patterson v. Alabama*, 294 U. S. 600 (1934); see *State Tax Comm. v. Van Cott*, 306 U. S. 511, 515 (1939).

37. Another procedure with precisely the advantages and disadvantages of that employed in the instant case was used in a similar situation. Respondent obtained a two week's continuance from the Supreme Court to enable the state court to amend its opinion. *International Steel & Iron Co. v. National Surety Co.*, 297 U. S. 657, 662 (1936).

38. *Minnesota v. National Tea Co.*, 60 Sup. Ct. 676, 679 (U. S. 1940).

39. The effect of such a remand is to reinvest the state court with full authority over the case. *Northern Pac. Ry. v. Concannon*, 239 U. S. 382 (1915); *Sioux City Bridge Co. v. Dakota County*, 260 U. S. 441 (1923).

40. *Georgia Ry. & Elec. Co. v. Decatur*, 297 U. S. 620 (1936); *Hanover Fire Ins. Co. v. Carr (Harding)*, 272 U. S. 494 (1926). *Schneider Granite Co. v. Gast Realty & Investment Co.*, 245 U. S. 288 (1917). These cases should dispose of the myth that a Supreme Court decision *must* be decisive of the particular litigation.

41. This is unlikely, however, in view of the court's commitment in the syllabus of its first opinion. *Cf. Virginia v. Imperial Coal Sales Co.*, 293 U. S. 15 (1934) where this was done in the state court's original opinion and the Supreme Court took jurisdiction to review.

as a matter of reason and persuasion; and there would still be the difficulty of getting around the rule of the *Central Savings* case to secure Supreme Court review.

Quite apart from the relatively unimportant question of whether the state court did or did not actually come to a *conclusion* based upon the state constitution (which is apparently the basis upon which the *National Tea* case opinion distinguished the *Central Savings* case) is the broader question of what the Supreme Court can do with a state decision in which the non-federal ground is frankly based upon federal law and cases. Intelligent disposition of this type of case would be greatly facilitated by the Supreme Court's deciding the federal question before remanding. If, as seems often the case, the state court had previously felt "bound" by the federal precedents, such a decision would settle the case. If the state court now preferred to differ explicitly with the Supreme Court in interpreting its own constitution, it would still be free to do so. In either event the responsibility for striking down or upholding state legislation would be distinctly placed. In times of Constitutional change this suggested procedure is particularly valuable in preventing state courts from transferring the onus of their judgments to federal cases which might be overruled or modified if the Supreme Court had an opportunity to reconsider them.<sup>42</sup>

The only jurisdictional difficulties with this course arise from the recent tendency to treat the non-federal ground rule as an automatic test of jurisdiction—a view which finds no statutory support and which is at variance with dicta and holding in almost every case prior to Supreme Court Rule 12.<sup>43</sup> Despite expressions in the *National Tea* case to the contrary, no rule other than a rule of convenience forbids decision of the federal question.<sup>44</sup> By analogy to cases in which the federal and non-federal grounds are "interwoven" jurisdiction could be convincingly maintained where, as here, the non-federal ground arises only as a result of the persuasion of federal authority. Moreover, such a course would seem much better calculated than the present rule to implement the high purpose of the Court as expressed by its present Chief Justice: "Review by the Supreme Court is thus in the interest of the law, its appropriate exposition and enforcement, not in the mere interest of the litigants."<sup>45</sup>

Basic constitutional doctrines touching the division of authority between state and federal courts are not to be lightly disturbed. But the non-federal ground rule concerns the needs of practical and politic administration rather than the substance of these doctrines. The real issue raised by the *National*

42. Cf. *Van Cott v. State Tax Comm.*, 96 P. (2d) 740 (1939); *Georgia Power Co. v. Decatur*, 181 Ga. 187, 182 S. E. 32 (1935).

43. See note 7 *supra*. Within very recent years cases have been both reversed and affirmed, apparently following the earlier methodology, despite the presence of non-federal grounds. *Awotin v. Atlas Exchange Nat'l Bank*, 295 U. S. 209 (1935) (affirmed); *Patterson v. Alabama*, 294 U. S. 600 (1934) (reversed); *Ancient Egyptian Arabic Order v. Michaux*, 279 U. S. 737 (1929) (reversed).

44. See *Minnesota v. National Tea Co.*, 60 Sup. Ct. 676, 680 (U. S. 1940).

45. Letter from Chief Justice Hughes to Senator Wheeler. SEN. REP. NO. 711, 75th Cong., 1st Sess. (1937) 38, 39; 81 CONG. REC. 3607 (1937).

*Tea* case is not which court should have the final word, but what procedure will best ensure that each court fulfills its allotted constitutional function. It is a problem best to be settled as a matter of policy in particular cases, not in terms of a rigid jurisdictional<sup>46</sup> rule.

## EXPULSION FROM STOCK EXCHANGES AS A CHECK TO MATCHED ORDERS AND OTHER MARKET MANIPULATION

SECTION 9 of the Securities Exchange Act of 1934,<sup>1</sup> designed to afford investors a more effective protection against market manipulation than was provided at common law,<sup>2</sup> has formed the spearhead of a campaign by the Securities and Exchange Commission to make market price a resultant of bona fide supply and demand.<sup>3</sup> Most comprehensive of the legislative bans is Section 9(a)(2), which prohibits creation of trading activity or raising or depressing of prices for the purpose of inducing others into or out of the market. Price-pegging—a less opprobrious and sometimes necessary<sup>4</sup> form

46. For an interesting defense of jurisdictional flexibility see Frankfurter, *Supreme Court at October Term, 1934* (1935) 49 HARV. L. REV. 68, 94.

\*Charles C. Wright v. Securities and Exchange Comm., N. Y. Times, May 21, 1940, p. 35, col. 7 (C. C. A. 2d).

1. 48 STAT. 889, 15 U. S. C. § 78i (1934).

2. The Securities Exchange Act of 1934 probably effects little change upon the common law itself. Its chief value lies in synthesizing the common law doctrines and in providing an effective machinery for their enforcement. Berle, *Liability for Stock Market Manipulation* (1931) 31 COL. L. REV. 264; Berle, *Stock Market Manipulation* (1938) 38 COL. L. REV. 393; Moore, *Market Manipulation and the Exchange Act* (1934) 2 U. OF CHI. L. REV. 46. The common law in this country is discussed in Brown v. United States, 5 F. Supp. 81 (S. D. N. Y. 1933), *aff'd*, 79 F. (2d) 321 (C. C. A. 2d, 1935), *cert. denied sub nom. McCarthy v. United States*, 296 U. S. 650 (1936).

3. The SEC, in attacking manipulation, has also made use of the fraud provisions of § 17(a) of the Securities Act of 1933, 48 STAT. 74 (1933), 15 U. S. C. § 77 (1934), and of the Federal Mail Fraud Act, 35 STAT. 1130 (1909), 18 U. S. C. § 338 (1934). Seeman v. United States, 90 F. (2d) 88 (C. C. A. 5th, 1937); United States v. Rollnick, 91 F. (2d) 911 (C. C. A. 2d, 1937). The provisions of the Securities Act and the Mail Fraud Act have been joined in criminal indictments. United States v. Alluan et al., 13 F. Supp. 289 (N. D. Tex. 1936); United States v. Bogy, 16 F. Supp. 407 (W. D. Tenn. 1936), *aff'd*, 96 F. (2d) 734 (C. C. A. 6th, 1938), *cert. denied*, 305 U. S. 603 (1938); Coplin v. United States, 88 F. (2d) 652 (C. C. A. 9th, 1937), *cert. denied*, 301 U. S. 703 (1937). The fraud provisions of the 1933 Act have also been used in conjunction with § 9(a)(2) of the 1934 Act. S.E.C. v. Torr, 15 F. Supp. 315 (S. D. N. Y. 1936), *rev'd*, 87 F. (2d) 446 (C. C. A. 2d, 1937), *inj. en'd.*, 22 F. Supp. 602 (S. D. N. Y. 1938); S.E.C. v. Otis & Co., 18 F. Supp. 100 (N. D. Ohio 1936), *aff'd*, 106 F. (2d) 579 (C. C. A. 6th, 1939); R. J. Koeppe & Co. v. S.E.C., 95 F. (2d) 550 (C. C. A. 7th, 1938).

4. For discussion of the desirability of price-pegging to facilitate primary distribution of securities by underwriters, see SEC Exchange Act Release No. 2446, Mar. 18, 1940, 3 *et seq.* TWENTIETH CENTURY FUND, THE SECURITY MARKETS (1935) 69 *et seq.*, 500.

of manipulation — though not outlawed, is placed under the strict surveillance of the Commission<sup>5</sup> by Section 9(a)(6). Matched orders and wash sales are expressly banned by Section 9(a)(1).<sup>6</sup> The sanctions provided to enforce these substantive provisions include criminal prosecutions started by the Department of Justice at the instigation of the Commission,<sup>7</sup> suits for injunction brought by the Commission in the district court,<sup>8</sup> and hearings before the Commission leading to orders, reviewable by the Circuit Court of Appeals,<sup>9</sup> suspending for not more than a year or expelling members from national securities exchanges.<sup>10</sup>

Since all manipulation cases brought to the courts under the Exchange Act have been disposed of under Section 9(a)(2),<sup>11</sup> the matched order provision has not received judicial construction. Uninterpreted, also, has been the scope of the Commission's power to expel or suspend members from national securities exchanges. Recently, however, a case posing the dual problem of construing the matched order provision and determining the effect to be given an expulsion order was decided by the Second Circuit Court of Appeals.<sup>12</sup> The Commission's expulsion order was predicated upon a finding that the appellant Wright had manipulated the common stock of the Kinner Corporation on the Los Angeles Stock Exchange in violation of Sections 9(a)(1) and 9(a)(2).<sup>13</sup> Just prior to Wright's market activity, while the price stood at 45 cents, two of his associates<sup>14</sup> acquired an option on 160,000 shares of Kinner stock at prices increasing from 45 to 60 cents per share. During the first day, Wright purchased, through controlled accounts, 18,500 shares at prices rising from 46 to 60, and sold 9,000 shares

5. The SEC has recently promulgated its first set of rules under this subsection, covering stabilizing operations on securities offered at the market price. Rules X-9A6-1 to X-9A6-6, 135 C. C. H. St. Exch. Regul. Serv. ¶¶ 5162-5166. See Comment (1940) 28 CALIF. L. REV. 378, 383. For a statement of the policy underlying these rules, see SEC Exchange Act Release No. 2446, Mar. 18, 1940.

6. A "matched order" is entered at substantially the same price, time, and size as a countervailing buy or sell order so that the two may cross and create a fictitious picture of activity upon the tape. A "wash sale" results where the operator is at once the buyer and seller, so that no change of beneficial ownership occurs.

7. § 32, 48 STAT. 904, 15 U. S. C. § 78ff (1934).

8. § 21(e), 48 STAT. 900, 15 U. S. C. § 78u(e) (1934).

9. § 25(a), 48 STAT. 901, 15 U. S. C. § 78y(a) (1934).

10. § 19(a)(3), 48 STAT. 898, 15 U. S. C. § 78s (1934).

11. See § 9(a)(2) cases cited note 3 *supra*. Other cases brought under § 9(a)(2) include S.E.C. v. Saphier, 135 C. C. H. St. Exch. Regul. Serv. ¶ 8529 (S. D. N. Y. 1936); S.E.C. v. Andrews, 88 F. (2d) 441 (C. C. A. 2d, 1937).

12. Charles C. Wright v. Securities and Exchange Comm., N. Y. Times, May 21, 1940, p. 35, col. 7 (C. C. A. 2d).

13. In Matter of Charles C. Wright, 3 S.E.C. 190 (1938).

14. Norman Stern and Herbert King, the holders of the option, were charged with acting in concert with Wright, and the three were joined in the proceedings before the SEC. Upon a finding that they had conspired with Wright in violating § 9(a)(2), Stern and King were each suspended for twelve months from membership in exchanges. In Matter of Charles C. Wright, 3 S.E.C. 190, 216 (1938). No appeal was brought from those orders.

at prices ranging from 55 to 60. The trading volume which previously had averaged only 730 shares a day surged to 36,800 shares. During the four succeeding trading days, through a nominal account, he sold 41,300 additional shares at prices ranging from 62½ to 75; 40,000 of these shares were obtained under the option. Thus the market price rose from 45 cents to 75 cents in a five day period during which Wright's purchases represented 79% of the total purchases on the exchange, and his sales 40% of total sales. On these findings of fact by the Commission the court sustained<sup>15</sup> the holding that Wright had violated Section 9(a)(2) by creating trading activity intended to enable him to unload the option stock upon investors at a profit.

The transactions alleged to constitute matched orders occurred on the first day. At 1:30 P.M., Wright entered through a discretionary account an order to sell 10,000 shares at 60. Ninety minutes later, the market having fallen to 57½ before any of that order had been executed, Wright entered a second order through another controlled account<sup>16</sup> to buy 2500 shares "at market." Both of these orders were entered upon his own initiative despite notice from his Los Angeles broker that a cross was likely to occur. The buy order was executed: 100 shares at 57½, and 2,400 at 60, of which 800 were from Wright's own sell order.<sup>17</sup>

The matched order section provides:

"It shall be unlawful . . . for the purpose of creating a false or misleading appearance of active trading in any security registered . . . to enter an order for the purchase of such security with the knowledge that an order or orders of substantially the same size, at substantially the same time, and at substantially the same price, for the sale of any such security, has been or will be entered by or for the same or different parties."

In construing this provision, the Commission pointed out that the statute prohibits, not the actual crossing of matched orders, but the entry of an order

---

15. A portion of the hearings before the trial examiner was removed from Washington to Los Angeles and thereafter to San Francisco. Wright did not attend these hearings, and contended that this removal to a point so distant deprived him of due process of law. As to the Los Angeles hearing Wright had notice, and the court held it a proper exercise of discretion by the SEC to order hearings conducted where numerous witnesses and original records of market transactions were located. Wright had no notice, however, of the transfer of hearings from Los Angeles to San Francisco, and the court held this "could not be condoned if the evidence taken at San Francisco were essential to sustain the order." But since the testimony was not indispensable to the case, and the Commission so stated in its findings, the court held this was not reversible error.

16. The device of operating through controlled accounts instead of in his own name prevented these orders from falling into the category of "wash sales." Their effect from Wright's point of view, however, was close to that of "wash sales," since his complete control over the transactions rendered the change in beneficial ownership little more than nominal.

17. A second matched order was found by the Commission to have occurred at 4 P.M., when Wright placed through a different broker a market order to buy 2,500 shares for his wife's account. This crossed, to the extent of 2,200 shares the unfilled portion of his prior order to sell 10,000 shares at 60.

under such circumstances that it may reasonably be expected to result in a fictitious picture. A violation thus occurs not upon the execution, but upon the entry of the order. The Commission contended, however, that the fact of an actual crossing might conclusively demonstrate that the orders had the similarity of size, time and price required to bring them within the statutory ambit. In finding that the orders met the requirement as to price, the Commission argued that when Wright entered his market buy order, he knew that it would "clean up"<sup>18</sup> all the stock offered at  $57\frac{1}{2}$  and that, as to a portion of the order, "market" and "60" would be the same. Hence, with regard to the 800 shares that actually crossed, the Commission contended that Wright bid "60" just as truly as if he had phrased the order in terms of that specific price. Proof of the requisite identity of time presented a more difficult problem. The Commission argued that the ninety-minute interim between the buy and sell orders was small compared to the time consumed by the manipulation as a whole; and that the orders were close enough to achieve Wright's purpose. In addition, focussing upon the statutory wording "enter an order," the SEC viewed Wright's order as being continuously offered by the broker until execution. The Commission's position with relation to size was based upon the exchange practice of considering orders not designated "all or none" as divisible into 100 share lots.<sup>19</sup> Under that view Wright's orders became, in effect, 100 orders to sell 100 shares, and 25 orders to buy 100 shares. The alleged matching occurred between eight of these orders in 100 share lots.

The court, disagreeing with the Commission's interpretation of "substantially the same size," turned the case on that point, without taking a position with respect to identity of price or time. Although conceding the soundness of the Commission's assumption that Wright knew of the exchange practice of splitting orders into 100 share lots, the court held that the evidence supplied by a 10,000 share sell order and a 2,500 share buy order was insufficient to support a finding of substantial identity of size. The holding is probably supported by the statutory view that matched orders are particularly reprehensible because they represent a riskless device for stimulating market activity and creating an artificial price. Where identical countervailing orders are placed simultaneously in controlled accounts, risk of loss to the manipulator may be completely eliminated. To the extent, however, that orders vary in price, time and size, the risk that the crossing will be intercepted by outside orders and that the manipulator will be forced to take a position increases.

---

18. "Clean up" is an expression used on the Exchange to denote the purchase of all the stock offered in the market at a particular price.

19. It is settled both in law and in exchange practice that an order to a broker to buy or sell securities is severable and, in the absence of contrary agreement or instruction, authorizes the broker to execute the order to whatever extent he finds possible. *Marye v. Strouse*, 5 Fed. 483 (C. C. D. Nev. 1880); *Evans v. Wrenn*, 93 App. Div. (N. Y.) 346 (1904). Moreover, the rules of the Los Angeles Stock Exchange provide that any order, unless specifically designated "all or none," must be executed in board lots—which, in the case of Kinner stock, are multiples of 100 shares. Brief for Respondent, p. 32, *Charles C. Wright v. S.E.C.*, N. Y. Times, May 21, 1940, p. 35, col. 7 (C. C. A. 2d).



Since the matched order provision is limited to situations in which the price, time and size are "substantially" identical, it seems intended to apply only where the risk of loss is actually minimized.

If this "riskless" rationale may be attributed to the court, strict construction of the "substantially the same size" provision does not necessarily render the section susceptible to easy evasion by the entry of orders differing in size. It is true that the "100 share lot" theory proposed by the Commission would have given the term "substantial" a high degree of elasticity. But the court's interpretation leaves ample leeway for the Commission to determine precisely what degree of risk must be present in a transaction to place it beyond the ambit of the matched order ban.

The danger to the manipulator that his activities may force him to take a position in the market depends upon many factors. Most apparent of those bearing upon "substantially the same size" are the extent of the disparity in size and the condition of the market when the orders are entered. If, for example, the orders are to sell 1,000 shares and buy 100, the potential risk of assuming a relatively large position is greater than if the orders are to sell 1,000 and buy 900. Again, if orders are entered during a period of active trading, the chance that concurrent bids or offers by outsiders will force the broker to take a position is greater than if activity has slackened. In practice, matched orders are usually resorted to at a time when trading is slight in order to register activity upon the tape.<sup>20</sup>

Another important element in evaluating the risk of assuming a position is the manipulator's current market position. The risk of loss from having a large sell order absorbed by outsiders in the early stages of a "mark-up" operation<sup>21</sup> will vary inversely to the strength of the operator's long position. If his position is fortified by a substantial low-priced option he may be completely protected from intercepting orders. The manipulator operating on a slim trading margin without an option, however, is highly vulnerable to the threat of having his orders intercepted by outsiders. Consequently he runs a more substantial risk of taking a position in entering countervailing orders which are not identically matched.

In view of these risk criteria, the holding in the *Wright* case may well be limited to the proposition that orders to sell 10,000 shares at 60 and to buy 2,500 shares "at market" entail sufficient risk of interception—and risk of loss in Wright's market position—to place them beyond the statutory prohibition.<sup>22</sup> The decision need not hamper the future application of this

---

20. Mathias, *Manipulative Practices and the Securities Exchange Act* (1936) 3 U. OF PITT. L. REV. 7, 25.

21. A "mark-up" operation is a series of transactions designed to increase the market price of a security. This operation, prior to 1934, customarily preceded the unloading of option stock on the market. See Comment, *Market Manipulation and the Securities Exchange Act* (1937) 46 YALE L. J. 624; FOWLER, *INTRODUCTION TO WALL STREET* (1930) 142.

22. The court may perhaps be criticized for not giving sufficient weight to the option which stood ready to cushion any shock to Wright's position. The market price had already been raised 15 points above the option price when the alleged matched order was effected.

section to transactions involving less risk. The result in the instant case might well have been otherwise had Wright's buy order been for 6,000 or 8,000 shares. Thus the court's attitude in the *Wright* case does not necessarily indicate an interpretation so strict as to vitiate this statutory attempt to ban matched orders, and may be regarded as leaving open a means of penalizing evasive devices which more closely achieve the prohibited result. Furthermore, where, as in the *Wright* case, a series of transactions create an artificial price for the purpose of inducing others to enter the market — even though the orders themselves successfully skirt the pitfalls of the matched order — the more comprehensive prohibition of Section 9(a)(2) stands ready to afford investors a substantial protection.

Equally significant as its construction of the matched order provision is the interpretation which the court has placed upon its power to review the Commission's choice of the expulsion remedy. The court affirmed the Commission's view that an expulsion order is not a penalty, but a remedial device for investor protection. Consequently a violation resulting in an expulsion order need not be proved beyond a reasonable doubt. Nor need it be supported upon review by a fair preponderance of the evidence, but only by substantial evidence. The opinion, however, is somewhat hazy regarding the scope of the court's review of a Commission order of suspension or expulsion. Apparently, the court separated review of the Commission entry of *any* order, expulsion or suspension from review of the Commission's choice between expulsion and suspension. The court seems to have taken the view that the SEC's finding that an order is "necessary or appropriate for the protection of investors" — a *sine qua non* under Section 19(a)(3) — must be supported by some proof. Such proof, however, may be no more than substantial evidence of a violation of one of the manipulation provisions of Section 9.

Not even this measure of review was retained by the court over the Commission's choice between suspension and expulsion. The majority of the court believed that the court had no power to "supervise the Commission's discretionary determination that expulsion was 'necessary or appropriate for the protection of investors.'" Judge Swan, who wrote the opinion, disagreed, taking the reasonable position that the court had the power to pass upon the severity of an order. He based his argument upon the meaning of the word "modify" in the section of the act that provides that a reviewing court may, in its discretion, "affirm, modify and enforce, or set aside" the order.<sup>23</sup>

In the belief, however, that expulsion was too severe a remedy in this case, the court remanded the cause in order that the Commission might determine, in its discretion, whether or not to reduce the order to one of suspension.<sup>24</sup> The court's reaction to the penalty was based in part upon its assumption that expulsion was a permanent step which could not be retraced. There is, however, no statutory reason why the Commission might not at a later date,

23. § 25, 48 STAT. 901, 15 U. S. C. § 78y (1934).

24. The court was impressed by the fact that this was Wright's first infraction of the Act, and that there was no indication that he was a habitual manipulator or would be likely to attempt further manipulation of the market. The remand was justified by the court's reversal of the Commission's interpretation of § 9(a)(1).

if so disposed, reinstate Wright upon direct application, or indirectly should Wright seek to register as an over-the-counter dealer with a national securities association under Section 15A.<sup>25</sup> An opposite conclusion would force the Commission to make one final and extreme choice between suspension for not more than one year and permanent expulsion.

The relinquishment by the court of a supervisory check upon the severity of an order is particularly significant in view of the almost complete discretion vested in the Commission to decree suspension or expulsion. The Commission is faced with the nice problem of determining the degree of culpability which warrants expulsion instead of suspension. No criterion is provided by the statute other than that the Commission must believe "such action necessary or appropriate for the protection of investors." Other proceedings by the Commission under Section 19(a)(3), the expulsion section, shed little light upon the Commission's standards of determination.<sup>26</sup>

The problem of determining the degree of penalty, if any, which is warranted by the evidence goes to the essence of judicial judgments. Yet the surrender of this broad range of judicial discretion to an administrative agency as competent as the Securities and Exchange Commission may well be justified by the extreme complexity of the subject matter involved and the Commission's superior vantage ground from which to weigh the evidence.<sup>27</sup> This power of the Commission, although more spectacular, is closely analogous to the power to revoke licenses frequently entrusted to administrative bodies.<sup>28</sup> Insurance against abuse of this power depends upon appellate review of the

25. § 15A(b) (4) prohibits an association of over-the-counter dealers from admitting to membership a broker or dealer who has been suspended or expelled from a national securities exchange. The Commission, however, may authorize admission if "appropriate in the public interest" 52 STAT. 1070, 15 U. S. C. 78o-3(b) (4) (Supp. 1938).

26. In six years, only eight proceedings other than the *Wright* case have been instituted under § 19(a) (3). In four of these no order was entered. Thomas F. Gagen (suspension for one year by consent); Harry A. Dart (expelled by the stock exchange); Abbott, Proctor, and Paine (voluntary resignation from membership); E. F. Hutton (proceeding dropped); see THIRD ANNUAL REPORT, SEC (1937) 71. Of the remaining four, only one resulted in expulsion. Michael J. Meehan, 2 S.E.C. 588 (1938). The other three were: Harold T. White *et al.*, SEC Exchange Act Release No. 1745, June 22, 1938 (90 day suspension); W. E. Hutton & Co., SEC Exchange Act Release No. 2033, Mar. 4, 1939 (30 and 90 day suspensions by consent); Junius A. Richards, SEC Exchange Act Release No. 2054, Mar. 27, 1939 (10 day suspension). None of these cases was appealed. For discussions of some of these cases, see Redmond, *An Experiment in Administrative Law* (1938) 47 YALE L. J. 622; Note (1939) 86 U. OF PA. L. REV. 638.

27. See Landis, *Significance of Administrative Commissions* (1937) 12 IND. L. J. 471, 475; LANDIS, *THE ADMINISTRATIVE PROCESS* (1938) 84 *et seq.*

28. There are many instances where Congress has conferred upon administrative agencies the power to revoke licenses. See *e.g.*, Packers and Stockyards Act, 42 STAT. 159 (1921), 7 U. S. C. § 181 (1934); Grain Futures Act, 42 STAT. 998 (1922), 7 U. S. C. § 1 (1934); Cotton Standards Act, 42 STAT. 1517 (1923), 7 U. S. C. § 51 (1934). The constitutionality of such delegations has been consistently upheld. *Moore v. Chicago Mercantile Exchange*, 90 F. (2d) 735 (C. C. A. 7th, 1937), *cert. denied*, 302 U. S. 710 (1938); *Brinkley v. Hassig*, 83 F. (2d) 351 (C. C. A. 10th, 1936); *Farmer's Livestock Comm. v. United States*, 54 F. (2d) 375 (E. D. Ill. 1931).

"substantial evidence" underlying findings of fact, and upon the willingness of the Commission to comply with recommendations of leniency made by the court.

The power to expel is an extremely sharp weapon,<sup>29</sup> to be used sparingly lest it produce unnecessary hardship. That the Commission is cognizant of this danger is evident from the fact that there have been only two expulsions in its six year history. Perhaps the greatest value of this sanction lies not in its actual exercise, but rather in its deterrent effect.<sup>30</sup> Stockbrokers as a class are particularly sensitive to such a threat, since the mere institution of an expulsion proceeding carries with it a stigma severely detrimental to their business. There is substantial indication that the Commission's future policy will be one of winning compliance by the threat of positive sanctions, rather than of penalizing or eliminating those who violate the Act.<sup>31</sup>

### FINALITY OF JUDGMENTS IN APPEALS FROM FEDERAL DISTRICT COURTS\*

THE joinder provisions<sup>1</sup> of the Federal Rules of Civil Procedure, which permit litigants to assert in a single suit any claims legal or equitable which may be outstanding between them, have necessitated a revision of the tests for determining the finality, for the purpose of appeal, of a district court

29. An interesting problem which may well face the SEC at some future date is the effect that can be given to an expulsion order. The Act does not empower the SEC to sell the offending member's seat and the SEC presumably will permit the sale to be executed in the same manner as if the stock exchange itself decreed the expulsion. The rules of the New York Stock Exchange provide that a member expelled for reasons other than insolvency may sell his seat privately. If the member refused to sell he might not be forced to do so by the New York Stock Exchange. The Exchange might take the view that expulsion by the SEC is not tantamount to expulsion by the Exchange itself, because the definition of the word "member" under the Exchange Act is broader than its meaning in the Exchange constitution. Furthermore, the constitutions of the New York Stock Exchange and of most other exchanges make no provision for expulsion other than by order of the Board of Governors upon finding a member guilty of willfully violating the Act. But if the Exchange cooperated as it probably would, expulsion by order of the Board of Governors might well be predicated upon a violation of Exchange rule against fictitious transactions [Constitution of the New York Stock Exchange, Art. xvi, § 3.], or upon the non-compliance with the SEC order itself. If, however, the Board was recalcitrant, the Commission might bring a mandamus proceeding in a district court to force the member to sell the seat himself. § 21(f), 48 STAT. 901, 15 U. S. C. § 78u(f). Or perhaps pressure might be applied to the Exchange itself under the threat of revoking its registration. § 19(a)(1). Such a step, however, is obviously so drastic that the Commission would be unlikely to resort to it.

30. It should be noted that the manipulation on a single exchange—the Los Angeles Stock Exchange—warranted expulsion from all five exchanges of which Wright was a member.

31. FIFTH ANNUAL REPORT, SEC (1939) 94.

\* *Collins v. Metro-Goldwyn Pictures Corp.*, 106 F. (2d) 83 (C. C. A. 2d, 1939).

1. FED. RULES CIV. PROC. 13 (b), (c); 14 (a); 18 (a), (b).

order. In an attempt to make this necessary adjustment, the Second Circuit Court of Appeals has recently indicated a basis upon which the traditional conception of the final determination of a suit<sup>2</sup> may be reconciled with the practical problems arising from this change in trial court procedure.<sup>3</sup>

The court's previous test of finality with regard to suits involving the joinder of claims is found in the case of *Sheppy v. Stevens*.<sup>4</sup> The general rule was there established that all the claims in litigation in a suit are to be considered as a single judicial unit which must be settled completely before any appeal may be taken.<sup>5</sup> In conjunction with the procedures effective in the district courts of the Second Circuit under the Conformity Act,<sup>6</sup> such a rule was clearly feasible and, indeed, probably the most satisfactory of possible rules. Since the state procedural systems of that circuit permitted the joinder only of causes of action closely related in form or content,<sup>7</sup> what were in appearance different claims were usually alternate ways of pleading on the basis of a single group of facts, or claims so closely related that an appellate court would for greatest convenience wish to consider them simultaneously. The rule was clear and certain of application, and not unduly harsh for litigants. Appeals were postponed only until all the claims arising from a single transaction or a closely related group of claims were disposed of by the trial court.

With the promulgation of the Federal Rules, however, the rule of *Sheppy v. Stevens* has become an anomalous doctrine. Conceived to fit a procedure in which every suit was the trial of a single cause or a small group of well-integrated causes, that rule is ill adapted to a procedural system under which

2. For the traditional view see *Collins v. Miller*, 252 U. S. 364, 370 (1920); *Arnold v. Guimarin & Co.*, 263 U. S. 427, 434 (1923); DOBIE, *FEDERAL JURISDICTION AND PROCEDURE* (1928) 792; ROSE, *FEDERAL JURISDICTION AND PROCEDURE* (4th ed. 1931) 575. For criticism of the final order rule see Crick, *The Final Judgment as a Basis for Appeal* (1932) 41 YALE L. J. 539.

3. *Collins v. Metro-Goldwyn Pictures Corp.*, 106 F. (2d) 83 (C. C. A. 2d, 1939). In addition to the opinion of the court by Judge A. Hand, there is a concurring opinion by Judge Clark dealing solely with the final order problem, *id.* at 86.

4. 200 Fed. 946 (C. C. A. 2d, 1912). Although *Sheppy v. Stevens* was not cited therein, the same rule was applied in *Stromberg Motor Devices Co. v. Arnson*, 239 Fed. 891 (C. C. A. 2d, 1917), also over-ruled by the *Collins* case.

5. The general language used in the decision makes no distinction between a suit which involves a single cause of action and one in which independent causes have been joined.

6. REV. STAT. § 914 (1875), 23 U. S. C. § 724 (1934). The states to whose practice that of the district courts of the Second Circuit conformed under this act were New York, Connecticut and Vermont.

7. In New York, until 1935, causes could be joined if they all fell within one of eleven different categories of claims, or if they arose out of the same transaction. N. Y. CODE OF CIV. PROC. (1914) § 484. Since 1935, unlimited joinder much like that in the Federal courts has been permitted. N. Y. CIV. PRAC. ACT (1939) § 258. But see Legis. (1937) 37 COL. L. REV. 462, 471 n. 51. Connecticut joinder practice closely resembles that of New York before 1935. CONN. GEN. STAT. (1930) § 5512. The Vermont practice preserves the distinction between legal and equitable actions, and does not permit claims to be joined even though they arise out of the same transaction. VT. PUB. LAWS (1933) § 1572, *Van Cleve v. Eastern Fruit Co.*, 91 Vt. 410, 100 Atl. 922 (1917).

a suit may be a heterogeneous collection of claims, some of which are alternative, some closely connected and some quite unrelated. Under the present federal district court practice, a plaintiff may join in his complaint any claims legal or equitable which he may have against the defendant,<sup>8</sup> provided only that the claims are within the jurisdiction of the court.<sup>9</sup> Counterclaims may be freely asserted by the defendant, even though he seeks therein relief different in kind from that sought in the complaint and arising out of totally different transactions.<sup>10</sup> This freedom of joinder is accompanied by a technical equipment adequate to handle the resulting agglomeration of claims in a single action. Thus separate trials of any claim or issue or of any group of claims and issues may be ordered by the court.<sup>11</sup> Even if separate trials have not been ordered, under Rule 54(b) separate judgments may be entered at various stages of the action as different claims are tried to conclusion. These provisions are designed to permit the district court judge freely to separate and group a confused mass of claims into appropriate units for judicial determination. In most circuit courts, under precedents like *Sheppy v. Stevens*, this convenient separation of distinct claims would be destroyed at the appeal stage,<sup>12</sup> and appellate determination of causes joined under the new Rules would be hopelessly delayed. These courts, moreover, would find no real benefit in such omnibus appeals, because they would be forced to separate the claims again in order to deal with them properly.

It was therefore natural that the Second Circuit Court of Appeals, in *Collins v. Metro-Goldwyn Pictures Corp.*,<sup>13</sup> should abandon the rule of *Sheppy v. Stevens*. In the district court proceedings<sup>14</sup> in the *Collins* case, one of two claims asserted by the plaintiff had been dismissed because it did not state facts sufficient to constitute a cause of action. On appeal from this dismissal, the circuit court, assimilating the order to a judgment under Rule 54(b),<sup>15</sup> held it final for purpose of appeal, and thus eliminated the

8. FED. RULES CIV. PROC. 18 (a), (b).

9. For discussion of the jurisdictional limitations on joinder see 1 MOORE'S FEDERAL PRACTICE (1938) 695; 2 *id.* at 2121; Shulman and Jaegerman, *Some Jurisdictional Limitations on Federal Procedure* (1936) 45 YALE L. J. 393.

10. FED. RULES CIV. PROC. 13 (b), (c) (as to an original defendant); 14 (a) (as to a third party defendant).

11. FED. RULES CIV. PROC. 42 (b).

12. Precedents similar to *Sheppy v. Stevens* may be found in decisions by the First Circuit Court, *Groblewski v. John Chmiell Co.*, 264 Fed. 325 (C. C. A. 1st, 1919); by the Fifth, *Wuerpel v. Canal-Louisiana Bank & Trust Co.*, 231 Fed. 934 (C. C. A. 5th, 1916); by the Sixth, *Kelsey Wheel Co. v. Universal Rim Co.*, 296 Fed. 616 (C. C. A. 6th, 1924); and by the Eighth, *United States v. Bighorn Sheep Co.*, 276 Fed. 710 (C. C. A. 8th, 1921). *Contra*: *Historical Pub. Co. v. Jones Bros. Pub. Co.*, 231 Fed. 784 (C. C. A. 3d, 1916); *Scriven v. North*, 134 Fed. 366 (C. C. A. 4th, 1904). *Cf.* *Klever v. Seawall*, 65 Fed. 373 (C. C. A. 6th, 1894); *Meurer Steel Barrel Co. v. Cleveland Steel Barrel Co.*, 268 Fed. 536 (C. C. A. 6th, 1920).

13. 106 F. (2d) 83 (C. C. A. 2d, 1939).

14. *Collins v. Metro-Goldwyn Pictures Corp.*, 25 F. Supp. 781 (S. D. N. Y. 1938).

15. The Rules went into effect Sept. 16, 1938. See FED. RULES CIV. PROC. 86. However, they were not applied to proceedings in copyright actions until Sept. 1, 1939. Order of United States Supreme Court, June 5, 1939, 59 Sup. Ct. clxxv. They did not, there-

difficulties attendant upon the continued application of the *Sheppy v. Stevens* doctrine. But the decision of the court to permit an appeal from judgment on less than all claims presented in the suit necessitates some delineation of the scope of a "claim" for purposes of appeal. If the benefits of segmentary judgments under Rule 54(b) are to be preserved, the definition of a claim must harmonize with the concept of a final order, to which the appellate jurisdiction of circuit courts of appeals is, in general, limited by statute.<sup>16</sup>

The solution indicated in the *Collins* case rests on the pragmatic theory of a cause of action as the total of all claims arising out of a single set of facts or a single transaction.<sup>17</sup> Although the Rules of Civil Procedure dispense with the phrase "cause of action,"<sup>18</sup> definition of which has created so much disagreement,<sup>19</sup> the pragmatic or transaction theory is implicit throughout.<sup>20</sup> Rule 54(b) can be understood or properly applied only when read in this light. A judgment may be entered, the Rule reads, "upon a determination of the issues material to a particular claim and all counterclaims arising out of the transaction or occurrence which is the subject matter of the claim." The rule thus clearly bases the entry of a judgment on the determination of a complete claim, not of individual issues.<sup>21</sup> Counterclaims relating to the

fore, directly govern the *Collins* case (decided Aug. 7, 1939), but the decision was based on the policy of the Rules in anticipation of their subsequent applicability to such suits. *Collins v. Metro-Goldwyn Pictures Corp.*, 106 F. (2d) 83, 85 (C. C. A. 2d, 1939). There was considerable confusion with regard to the application of the Rules to copyright suits until the order of June 5, 1939. Compare *White v. Reach*, 26 F. Supp. 77 (S. D. N. Y. 1939) with *Sheldon v. Metro-Goldwyn Pictures Corp.*, 26 F. Supp. 134 (S. D. N. Y. 1938).

16. 26 STAT. 828 (1891), as amended; 28 U. S. C. § 225 (Supp. 1939). The Federal Rules, which by the terms of the Enabling Act under which they were promulgated apply only to district court practice, can naturally have no effect upon the appellate jurisdiction of a circuit court of appeals. 48 STAT. 1064 (1934), 28 U. S. C. § 723b (1934). See 3 MOORE'S FEDERAL PRACTICE (1938) 3155. Hon. W. D. Mitchell, the chairman of the Advisory Committee, while admitting that Rule 54 (b) might in a sense "change the right of appeal or the necessity for it," has stated that this is "not really so." PROCEEDINGS OF A. B. A. INSTITUTE, WASHINGTON AND NEW YORK (1938) 329.

17. See CLARK, CODE PLEADING (1928) 75-87; Clark, *The Code Cause of Action* (1924) 33 YALE L. J. 817; Clark, *The Cause of Action* (1934) 82 U. OF PA. L. REV. 354. This interpretation of Rule 54 (b), not expressed clearly in the majority opinion, was emphasized particularly in Judge Clark's concurring opinion. It has been clarified and elaborated in his subsequent opinions in *Rosenblum v. Dingfelder*, 111 F. (2d) 406 (C. C. A. 2d, 1940) and *Atwater v. North American Coal Corp.*, 111 F. (2d) 125, 126 (C. C. A. 2d, 1940) (concurring opinion).

18. See 1 MOORE'S FEDERAL PRACTICE (1938) 145.

19. See McCaskill, *Actions and Causes of Action* (1925) 34 YALE L. J. 614; Gavit, *A "Pragmatic Definition" of the "Cause of Action"?* (1933) 82 U. OF PA. L. REV. 129; Gavit, *The Cause of Action—A Reply* (1934) 82 U. OF PA. L. REV. 695.

20. See FED. RULES CIV. PROC. 10 (b); 13 (a), (g); 15 (c); 54 (b), in all of which a single transaction or occurrence is a determining element for various purposes.

21. The Advisory Committee has cited statutes of Wisconsin and New York: as comparable to 54 (b). NOTES TO FED. RULES CIV. PROC. 50. Experience under these statutes, however, is of no value for federal purposes. The Wisconsin statute provides for a judgment against one of several defendants or for a judgment substantially settling a claim with an accounting or special issue outstanding. Such judgments, even if clearly

same transaction or occurrence must also be finally adjudicated in order that all the problems arising from the set of facts in question will be settled before an appeal is taken.<sup>22</sup> Alternative claims or overlapping claims are to be considered as only one claim for purpose of judgment under 54(b),<sup>23</sup> because they deal with a single fact situation.<sup>24</sup>

By limiting judgments under Rule 54(b) to final determinations of all the issues relevant to a single transaction, the traditional conception of a final order is preserved, in the sense that the judicial unit presented on appeal will be no smaller than it was formerly.<sup>25</sup> Satisfactory as this adjustment

---

interlocutory, may and indeed must be appealed individually, and hence the final order problem does not arise. WIS. STAT. (1939) § 270.54, *Richter v. Standard Mfg. Co.*, 224 Wis. 121, 271 N. W. 14 (1937). The New York statute permits a final appealable judgment as to "a part of a cause of action" and hence the only consideration in applying it is one of trial convenience. N. Y. CIV. PRAC. ACT (1939) § 476; *Lowe v. Lowe*, 265 N. Y. 197, 192 N. E. 291 (1934).

22. See 3 MOORE'S FEDERAL PRACTICE (1938) 3157.

23. *Rosenblum v. Dingfelder*, 3 Fed. Rules Serv. 54b.31-1 (C. C. A. 2d, 1940).

24. If the district court judge issues an order disposing of an issue less than a claim, this must be construed as an interlocutory order analogous to the partial summary judgment provided for in Rule 56 (d), which is clearly not appealable. 3 MOORE'S FEDERAL PRACTICE (1938) 3191. Such interlocutory orders are clearly contemplated by Rule 42 (b), which permits separate trials of any claim or issue. To forestall completely any temptation to appeal such a judicial disposition, the judge might state clearly his findings of fact and his conclusions of law and state that the court would direct the entry of the appropriate judgment when the remaining issues were settled. This is the exact opposite of the practice of entering the order and withholding the findings which is suggested in *Ilsen and Hone, Federal Appellate Practice as Affected by the New Rules of Civil Procedure* (1939) 24 MINN. L. REV. 1, 37. Such a practice would be unfair to litigants because it keeps them unnecessarily in the dark as to the basis of the court's decision. The propriety of district court control over appellate jurisdiction by either method, however, is questionable.

25. Although there have been definite statements by the Supreme Court that an appealable order must be final "as to all the causes of action involved," the cases in which this sweeping rule is expressed involve one set of operative facts and hence, under the transaction theory, one cause of action. See *Collins v. Miller*, 252 U. S. 364, 370 (1920) (single factual basis of the petition was illegal detention). See also *John Simmons Co. v. Grier Bros. Co.*, 258 U. S. 82 (1922) (claims for patent infringement and unfair competition arising out of a single product); *Ex parte National Enameling Co.*, 201 U. S. 156 (1906) (one product claimed to infringe a single patent). In cases involving several distinct claims, the Court has adopted a different policy. *United States v. River Rouge Imprvt. Co.*, 269 U. S. 411 (1926) (order finally disposing of all issues between certain parties, although litigation continued in respect to different causes between other parties, held final); *Savannah v. Jesup*, 106 U. S. 563 (1883) (order disposing of claims of a party intervening in foreclosure proceedings, final); *Ex parte Tiffany*, 252 U. S. 32 (1920) (order disposing of special application in receivership proceedings, final); *Trustees v. Greenough*, 105 U. S. 527 (1882) (order settling claims minor and incidental to the main controversy, final). Cases like *Collins v. Metro-Goldwyn Pictures Corp.*, in which more than one claim is being litigated between two parties and a judgment is entered on only one of these claims, have been presented to the Supreme Court infrequently, but such orders have been held final. *St. Louis, I. M. & S. R. R. v. Southern Expr. Co.*, 108 U. S. 24 (1883); *Hill v. Chicago & Ev. R. R.*, 140 U. S. 52 (1891).



of the traditional final order rule to the new district court procedure may seem in theory, however, it must still be determined whether the necessary measure of certainty for district judges and litigants has been preserved. The confusion evident in recent cases in the Second Circuit might well lead to a conclusion that the new test is too indefinite and too uncertain to be applied accurately and confidently by those concerned with the trial below.<sup>26</sup> A judge may be influenced by the decision in the *Collins* case to interpret Rule 54(b) as permitting entry of judgments freely throughout the course of the trial, although only one cause of action is in litigation;<sup>27</sup> a litigant may feel that in order to protect himself, he must appeal immediately from orders which would formerly have been considered clearly interlocutory.<sup>28</sup> Much of this misunderstanding might arise from the failure of the majority opinion to specify clearly the test by which a cause of action is to be delimited, and from certain language therein which could be construed to mean that, at the discretion of the district court judge, any issue may be finally adjudicated and appealed.<sup>29</sup> Subsequent decisions have clarified the rule of the *Collins* case, however, and should eliminate confusion from these sources.<sup>30</sup>

The more serious problem arising from the *Collins* decision, if the case be accepted at its face value, concerns not the general interpretation of Rule 54(b) in terms of the transaction theory of a cause of action, but rather the application of the theory to the particular facts of that case. The two claims held therein to constitute separate causes of action were for copyright infringement and unfair competition, claims which in many cases are held to be merely alternative or, as expressed in *Hurn v. Oursler*, "different epithets to characterize the same group of circumstances."<sup>31</sup> In distinguishing the latter case, the court argued that the *Collins* copyright claim, which concerned the infringement of the contents of a book by a motion picture, and the unfair competition claim, which concerned the alleged misuse of the title of the book, rested on distinct factual bases and were supported by different evidence.<sup>32</sup> Although it is true that the transactions were not identical, such an interpretation of the cause of action seems to differ from that indicated

26. See *Rosenblum v. Dingfelder*, *infra* note 27; *Atwater v. North American Coal Corp.*, *infra* note 28.

27. In a case involving two similar claims and only one real cause of action, three separate judgments were entered. *Rosenblum v. Dingfelder*, 111 F. (2d) 406 (C. C. A. 2d, 1940).

28. In the case of *Atwater v. North American Coal Corporation*, 111 F. (2d) 125 (C. C. A. 2d, 1940), an appeal was taken from an order dismissing counts with leave to amend and from an order dismissing counts as to less than all the defendants, although such orders have repeatedly been held not final. *Heike v. United States*, 217 U. S. 423 (1910); *Hohorst v. Hamburg-American Packet Co.*, 148 U. S. 262 (1893); *Shultz v. Manufacturers & Traders Trust Co.*, 103 F. (2d) 771 (C. C. A. 2d, 1939).

29. "It may be said that the sanction of an appeal in a case like the present will add to the complexity of litigation and unnecessarily multiply reviews. This, however, will as a practical matter remain within the control of the district judge." *Collins v. Metro-Goldwyn Pictures Corp.*, 106 F. (2d) 83, 86 (C. C. A. 2d, 1939).

30. See cases cited *supra* note 17.

31. 289 U. S. 238, 246 (1933).

32. 106 F. (2d) 83, 85, 87 (C. C. A. 2d, 1939).

in many Supreme Court cases which define the scope of particular causes of action.<sup>33</sup> Since the concept, however, was being used in these cases in a context other than the determination of the finality of a judgment, the court in the *Collins* case felt free to employ a different concept for final order purposes.<sup>34</sup> By thus making decisions defining a cause of action of little value for final order purposes unless they deal directly with that problem, the case has produced an uncertainty for litigants which seemingly can be dissipated only by the slow accumulation of a sizable body of final order precedents. This uncertainty is accentuated by the fact that the concept of a cause of action here used for final order purposes — partly resting, as it does, upon the independence of the nature of proof involved — is narrower than that more generally utilized by the Supreme Court. Although this interpretation makes possible a degree of appellate court discretion in the interests of its own convenience,<sup>35</sup> litigants might feel more secure in conserving appeals until complete determination of a case had the *Collins* concept of a cause of action conformed more closely to the broader Supreme Court theory.

In view of the uncertainties thus created, it is possible that the *Collins* case is being accorded a significance different from that intended by the court. It is at least arguable that the court contemplated that the narrow view of the cause of action there enunciated would be utilized only when a litigant seeks to appeal before complete determination of all claims embraced in a case. If the appeal in the *Collins* case had been taken after complete disposition of the case by the district court, it does not necessarily follow that the

---

33. See *Hurn v. Oursler*, 289 U. S. 238 (1933) (scope of cause of action to determine federal jurisdiction); *United States v. California and Oregon Land Co.*, 192 U. S. 355 (1904) (land patents attacked at different times on completely different grounds; held one cause of action for purpose of res judicata); *Moore v. New York Cotton Exchange*, 270 U. S. 593, 609 (1926) (claim and counterclaim, although resting on different operative facts, held to arise from one transaction for purpose of federal jurisdiction); *Maty v. Grasselli Chemical Co.*, 303 U. S. 197 (1938) (amendment broadening source of injuries sustained by employee, held to relate back to defeat statute of limitations because all pleadings concerned a single group of injuries). See also Judge Clark's dissent taking a broad view of a cause of action for purposes of federal jurisdiction in *Lewis v. Vendome Bags, Inc.*, 108 F. (2d) 16, 18 (1939); *Friederichsen v. Renard*, 247 U. S. 207 (1918) (statute of limitations); *Baltimore Steamship Co. v. Phillips*, 274 U. S. 316 (1927) (res judicata); *Southern Pac. Co. v. Van Hoosear*, 72 F. (2d) 903 (C. C. A. 9th, 1934) (res judicata).

34. 106 F. (2d) 83, 85, 87 (C. C. A. 2d, 1939). See Justice Cardozo's dictum that "A 'cause of action' may mean one thing for one purpose and something different for another." *United States v. Memphis Cotton Oil Co.*, 288 U. S. 62, 67 (1933).

35. There is much to be said for the position that appealability should not rest completely upon the abstraction of a cause of action but, within the limits of practical finality, should also be determined by considerations of appellate convenience. Cf. *Cobble-dick v. United States*, 60 Sup. Ct. 540 (U. S. 1940). By narrowing the concept of a cause and thus creating some flexibility, the appellate court may entertain appeals which, although not completely distinct under the transaction theory, may justify appealability because separate consideration does not duplicate appellate court effort. Such an appeal would be one which involved only legal issues not raised by related claims.

circuit court would have held that the appellant had lost his opportunity to appeal from the first judgment because the appeal time had run.<sup>30</sup> Were the court clearly to indicate that the *Collins* rule is to be applied only where the appeal is taken early and not where it is delayed, litigants doubtful of the proper application of the cause of action test would not feel it necessary to protect themselves by appealing from every order which might possibly be construed as an appealable judgment.

Although this interpretation of the *Collins* case contemplates an optional appeal hitherto unrecognized expressly by the judiciary, its justification rests on the assurance which it affords litigants otherwise confused as to the timeliness of their appeals. The adoption of this view of the *Collins* case may well involve a radical reorientation of the traditional conception of a final order; nevertheless, it is perhaps the only completely satisfactory solution to appellate uncertainties created by the liberalizing of district court joinder practice.

### COMPENSATION TO TRUSTEE FOR USE OF RAILROAD EQUIPMENT UNDER DISAFFIRMED LEASE\*

IN the intricate hierarchy of railroad capital structures the equipment trust obligation occupies a unique position. Secured by the least permanent part of the railroad plant, it is nonetheless regarded as safer than a first mortgage bond.<sup>1</sup> Even when railroad securities are "put through the wringer," the equipment trust is generally untouched.<sup>2</sup> When, however, a railroad, insolvent and in reorganization, possesses equipment no longer necessary for its operation, the position of the equipment trust is severely tested. Such a situation has arisen in the case of the Florida East Coast Railway Co. Series D Equipment Trust. Proceedings by the trustee in the equity reorganization court are significant in evaluating various remedies of the certificate holders after disaffirmance of the lease.<sup>3</sup>

The railroad had expanded rapidly during the Florida boom of the '20s, and in the process had acquired much equipment under standard "Philadelphia Plan" equipment trust leases.<sup>4</sup> The receivers who came into control in

---

36. Although an appellate court, in such a close case, might not dismiss the suit *sua sponte*, a motion to dismiss the appeal on the grounds that it is too late would probably be raised by the appellee. If the concept of a cause of action has any flexibility at all, it would be applied differently to an inclusive appeal than to a segmentary appeal in such a case.

\* New York Trust Co. v. Kenan, U. S. Dist. Ct., S. D. Fla., Feb. 2, 1940.

1. See DUNCAN, EQUIPMENT OBLIGATIONS (1924) 10.

2. See, e.g., the recent drastic reorganization proposed by the ICC for the New Haven. 6 POOR'S FINAN. RECORDS, RAILROADS 4205 (April 23, 1940).

3. New York Trust Co. v. Kenan, U. S. Dist. Ct., S. D. Fla., Feb. 2, 1940.

4. So called because it originated in Pennsylvania, a contract by the Schuylkill Navigation Co. in 1845 being considered the first example. The characteristic feature of the Philadelphia Plan is use of a lease rather than a conditional sale or chattel mort-

1931,<sup>5</sup> after the collapse of the boom, found themselves with a surplus of rolling stock, much of it in bad repair. The Series D equipment, consisting principally of 20 locomotives and 300 freight cars, appears to have been in particularly bad shape. In May, 1932, a mortgage trustee intervened, as is customary, in the creditors' receivership action, and was granted foreclosure and appointment of the same receivers to operate the road in the interests of bondholders and other creditors.<sup>6</sup> The receivers made some payments on account toward the equipment obligations and were granted extensions on the rest. In 1934, however, they procured authorization to disaffirm the Series D lease,<sup>7</sup> and permitted a default to occur. A committee representing equipment trust certificate holders, anxious to avoid disaffirmance, thereupon entered into protracted negotiations with the receivers which came to an end in 1936 when the option to disaffirm was exercised.<sup>8</sup> Although the equipment trustee could have obtained leave simply to enter and retake the equipment, it determined to secure a more formal judicial sanction. Accordingly, in April, 1936, a decree was obtained reciting the default, upholding the validity of the lease, determining the sum due, and allowing the trustee a judicial sale. The purpose of this virtually unprecedented sale was to protect the receivers in delivering possession, to insure marketable title in the trustee, and to fix with finality the amount of the railroad's obligation. After the sale, at which the trustee purchased most of the equipment for the benefit of the certificate holders, the trustee obtained a deficiency decree for the remainder of the purchase price.<sup>9</sup> When it subsequently became apparent that the deficiency judgment could not be collected out of the railroad's assets, the successor trustee instituted an action in 1939 against the receivers<sup>10</sup> to obtain compensation for their use and possession from 1931 to 1936.

In the latter action the receivers, analogizing the lease enforcement decree to a mortgage foreclosure and suit for the purchase price and relying upon the Florida rule that a vendor in a conditional sale who sues for the purchase price is held to have elected to regard title as having passed to the vendee, and may not, thereafter, sue to obtain possession,<sup>11</sup> advanced the

---

gag. DUNCAN, *op. cit. supra* note 1, at 18. The use of this complex form of financing is generally attributed to a desire to obtain priority over after-acquired property causes in railroad mortgages. DUNCAN, *op. cit. supra* note 1, at 14. But it seems that the same result might be attained by other methods. See *Fosdick v. Schall*, 99 U. S. 235 (1878) (conditional sale); *Harris v. Youngstown Bridge Co.*, 90 Fed. 322 (C. C. A. 6th, 1898) (purchase money mortgage). Its persistence is probably due to tradition and to the simplicity of recordation and unquestioned validity given by statute in all states. These are collected by DUNCAN, *op. cit. supra* note 1, at 324.

5. *Standard Oil Co. v. Florida East Coast Ry.*, U. S. Dist. Ct., S. D. Fla., 1931 (unreported case).

6. *Florida East Coast Equity Proceeding*, Doc. 84, Court Record Vol. I, p. 421.

7. *Florida East Coast Equity Proceeding*, Doc. 312, Court Record Vol. III, p. 325.

8. *Florida East Coast Equity Proceeding*, Doc. 517, Court Record Vol. IV, p. 555.

9. *Florida East Coast Equity Proceeding*, Doc. 665, Court Record Vol. V, p. 478.

10. *Florida East Coast Equity Proceeding*, Doc. 767, Court Record Vol. VI, p. 155.

11. *Central Farmer's Trust Co. v. McCampbell Furniture Stores*, 128 Fla. 60, 174 So. 748 (1937); *Robertson v. Northern Motor Securities Co.*, 105 Fla. 644, 142 So. 226 (1932); *Vosges Motor Co. v. Ward*, 98 Fla. 304, 123 So. 785 (1929); *American Process Co. v. Florida White Pressed Brick Co.*, 56 Fla. 116, 47 So. 942 (1908).

earlier decree as a bar to the present action upon the grounds of election of remedies, merger and *res judicata*.<sup>12</sup> The court, overruling this defense and sustaining the trustee's right to bring the action,<sup>13</sup> relied principally upon a provision of the lease agreement giving the trustee cumulative remedies.<sup>14</sup> It held, also, that the 1936 decree should not be held to operate retroactively<sup>15</sup> so as to deprive the trustee of title between 1931 and 1936, the period for which compensation was sought. Such operation would have the anomalous effect of transferring title to the railway as of the beginning of the receivership or the making of the lease, contrary to the unquestionable understanding of the parties at those times.

The decision seems clearly correct, not only upon the grounds given, but also because the prior action was not a mortgage foreclosure or a conventional suit for the purchase price, but, as the wording of the decree makes clear, a special equitable suit for the enforcement of the lease agreement according to its terms. Application of the Florida conditional sale doctrine to equipment trust leases, in the face of a Florida statute<sup>16</sup> specifically making lawful the retention of title in the trustee under such agreements until the purchase price is fully paid, seems an undesirable extension of a doctrine not too well founded at best.<sup>17</sup> Furthermore, there is good authority for giving the trustee the right to maintain an action for compensation even if title is assumed to be in the railroad subject to a vendor's lien in the trustee.<sup>18</sup>

That the owner of leased property has a right to compensation for use and possession by the receiver of the lessee is well settled, both in railroad equipment trust and other cases.<sup>19</sup> The nature of the right, important to know in

12. Answer of Receivers, pp. 13, 14.

13. The court referred to a master determination of the damages due the trustee and the method to be used in ascertaining them.

14. Lease Agreement (July 1924) between Banker's Trust Co., as trustee, and Florida East Coast Ry., pp. 11, 12. The provision uses broad language, specifying that every power or remedy given shall be "in addition to" every other power or remedy given or existing at law or equity, and that the exercise of one shall not be a waiver of the right to exercise any other.

15. No direct precedents for this have been found. The Florida cases, however, in their choice of words tend to identify passage of title with the day of the decree. See *Central Farmer's Trust Co. v. McCampbell Furniture Stores*, 228 Fla. 60, 62, 174 So. 748 (1937) ("that the title passed . . . by operation of law on July 24, 1928").

16. FLA. COMP. GEN. LAWS ANN. (Skillman, 1927) § 6597.

17. The doctrine has been sharply criticized and seems to be a minority rule. *Wm. W. Bierce, Ltd. v. Hutchins*, 205 U. S. 341 (1907); *Ratchford v. Cayuga County Cold Storage & W. Co.*, 217 N. Y. 565, 112 N. E. 447 (1916); *Weidenbach-Dubelin Co. v. Anderson*, 168 Wis. 212, 169 N. W. 615 (1918). It is felt that such a rule denies to the vendor the benefit of his retention of title and that the inconsistency is only apparent, not real. The cases are collected in Note (1921) 12 A. L. R. 503, where it is pointed out that courts which hold the remedies inconsistent have assumed the inconsistency without demonstrating it. Satisfaction from either remedy always bars the other. *Continuous Zinc Furnace Co. v. American Smelting & Refining Co.*, 61 F. (2d) 958 (C. C. A. 2d, 1932).

18. *Kneeland v. American Loan Co.*, 136 U. S. 89 (1890).

19. *Thomas v. Western Car Co.*, 149 U. S. 95 (1893); *Sunflower Oil Co. v. Wilson*, 142 U. S. 313 (1892); *Kneeland v. American Loan Co.*, 136 U. S. 89 (1890); *Myer*

fixing the amount of compensation and the priority of the trustee as against other creditors, is somewhat uncertain, but more recent cases appear to regard it as an equitable obligation of a unique sort.<sup>20</sup> The receiver is not an assignee of the term, and is not liable upon the covenants of the lease unless he can be held to have adopted it.<sup>21</sup> He is entitled to a reasonable period within which to decide whether to adopt or disaffirm, and courts are reluctant to hold that he has adopted in the absence of a clear showing. This being true, the courts base his liability for use upon the fact that as custodian for the court he has taken possession, and made use, of property belonging to others; therefore, since a court of equity will not do inequity, the owner is entitled to compensation.<sup>22</sup>

This concept of the lessor's right as an equity among other equities in the receivership court, rather than as a clear cut legal right, creates a number of problems both as to the receiver's liability and as to determination of the lessor's compensation. If the receiver actually makes use of the property or attempts to prevent the lessor from retaking, there is little doubt as to his liability. If, however, he merely holds the property without either constructive or actual use thereof, some courts in non-railroad cases have trouble in finding him answerable.<sup>23</sup> The usual test in non-railroad cases is possession, or, occasionally, benefit to the receivership estate.<sup>24</sup> In railroad equipment trust cases, however, receivers have been held liable for all equipment retained independently of the use made of it.<sup>25</sup> The most persuasive rationale

---

*v. Car Co.*, 102 U. S. 1 (1880); *Platt v. Philadelphia & R. R. R.*, 84 Fed. 535 (C. C. A. 3d, 1898); *Central Trust Co. v. Marietta & N. G. Ry.*, 48 Fed. 875 (C. C. A. 5th, 1891); *Coe v. New Jersey Midland Ry.*, 27 N. J. Eq. 37 (1876); *Hubbell v. Texas So. Ry.*, 59 Tex. Civ. App. 157 (1910), *writ of error refused*, 104 Tex. 712 (1911); *In re United Cigar Stores Corp.*, 69 F. (2d) 513 (C. C. A. 2d, 1934) (store property); *Oscar Heineman Corp. v. Nat Levy Co.*, 6 F. (2d) 970 (C. C. A. 2d, 1925) (store property); *Dayton Hydraulic Co. v. Felsenthal*, 116 Fed. 961 (C. C. A. 6th, 1902) (real estate); *Stokes v. Hoffman House*, 167 N. Y. 554, 60 N. E. 667 (1901) (real estate); *Prenatt v. Messenger Printing Co.*, 250 Pa. 406, 95 Atl. 564 (1915) (machinery).

20. *Oscar Heineman Corp. v. Nat Levy & Co.*, 6 F. (2d) 970 (C. C. A. 2d, 1925); *Stokes v. Hoffman House*, 167 N. Y. 554, 60 N. E. 667 (1901).

21. *Sunflower Oil Co. v. Wilson*, 142 U. S. 313 (1892); *In re United Cigar Stores Corp.*, 69 F. (2d) 513 (C. C. A. 2d, 1934); *Stoepel v. Union Trust Co.*, 121 Mich. 281, 80 N. W. 13 (1899); *Stokes v. Hoffman House*, 167 N. Y. 554, 60 N. E. 667 (1901).

22. *Oscar Heineman Corp. v. Nat Levy & Co.*, 6 F. (2d) 970 (C. C. A. 2d, 1925); *Frank v. Denver & R. G. Ry. Co.*, 23 Fed. 123 (C. C. Colo. 1885).

23. *Universal Rim Co. v. Scott*, 21 F. (2d) 346 (N. D. Ohio 1922). But *cf.* *Dayton Hydraulic Co. v. Felsenthal*, 116 Fed. 961 (C. C. A. 6th, 1902).

24. *Matthews v. Butte Machinery Co.*, 286 Fed. 801 (C. C. A. 9th, 1923) (possession); *Dayton Hydraulic Co. v. Felsenthal*, 116 Fed. 961 (C. C. A. 6th, 1902) (possession); *Universal Rim Co. v. Scott*, 21 F. (2d) 346 (N. D. Ohio 1922) (benefit); *accord Prenatt v. Messenger Printing Co.*, 250 Pa. 406, 95 Atl. 564 (1915). The only clear-cut rule exempting the receiver from liability where he retains the property is where it is subleased; in that case he does nothing but furnish essential services, heat, etc., and collect rents, making them available for the landlord. *Irving Trust Co. v. Densmore*, 66 F. (2d) 21 (C. C. A. 9th, 1933); *Mehan v. King*, 54 F. (2d) 761 (C. C. A. 1st, 1932) (bankruptcy).

25. There is no mention in the reported cases of an examination into the use. In *Thomas v. Western Car Co.*, 149 U. S. 95 (1893), the receiver made an informal agree-

is that the bondholders requested the court to take possession of all the equipment, that it was their duty, and not that of the court upon its own motion, to return such of it as they could not use, and that failing to do so they must pay compensation for retention of all.<sup>26</sup> In the instant case, some doubt may be created by the fact that the equipment trust certificate holders' committee was anxious to avoid disaffirmance and, in fact, urged the receivers to retain the equipment.<sup>27</sup> The sole power of effective disposition of the equipment remained, however, with the receivers and they used some of the equipment; furthermore mere possession of the remainder was probably useful, since the equipment was available for "stand by" service.<sup>28</sup>

In fixing compensation the courts initially were inclined to award the contract rate for the period between the establishment of the receivership and the return of the equipment.<sup>29</sup> Although such an award has the merit of simplicity, there is no necessary reason why the stipulated contract rental should correspond to an equitable and just compensation for use, particularly since the contract rate in equipment trusts includes both pure compensation for user and amortization of the purchase price.<sup>30</sup> Thus courts at present usually award reasonable rental, the contract rate being *prima facie* reasonable unless the contrary is shown.<sup>31</sup> If the reasonableness of the contract rate is effectively rebutted, the court must independently determine a reasonable rate. The first question is whether the rate shall be based on value to the lessee, fixed either on a mileage basis or on the basis of earnings during the period, or on value to the lessor as fixed by some percentage return on the depreciated investment value of the property (referred to hereafter as the investment plus maintenance formula).<sup>32</sup> Compensation may also be determined by use of the car rental formulas applied between independent railroads where equipment moves off the owning line.

In deciding which procedure to follow, the lack of precedent in equipment trust cases suggests judicial recourse to analogous situations. Where a railroad, different parts of which are covered by different mortgages, goes into

---

ment to use 138 out of 194 cars leased. The owners replevied the remaining 56 from the C. & N. W. Ry. and turned them over to the receiver, who retained but did not use them. He was held liable for all the cars.

26. *Frank v. Denver & R. G. Ry. Co.*, 23 Fed. 123 (C. C. Colo. 1885).

27. Answer of Receivers p. 5.

28. "Stand by" service means that the equipment is ready for use if required. Such equipment is valuable since the demand for a railroad's services fluctuates; yet it must, as a common carrier, stand ready to carry all who ask. Such a reserve is particularly necessary to a line with intensely seasonal business like the Florida East Coast.

29. See *Sunflower Oil Co. v. Wilson*, 142 U. S. 313 (1892). But see *Myer v. Car Co.*, 102 U. S. 1 (1880).

30. On the other hand it is argued that since there is a considerable initial payment, a stipulated rental amortizing the rest of the purchase price may not exceed reasonable compensation for user.

31. All the cases cited *supra* note 19, except the *Sunflower Oil* case, awarded compensation on a reasonable rental basis. *Oscar Heineman Corp. v. Nat Levy & Co.*, 6 F. (2d) 970 (C. C. A. 2d, 1925), is an example of the use of the stipulated rent as *prima facie* reasonable.

32. Included within "maintenance" are not only repairs, but also depreciation, taxes, insurance and any other proper charges.

receivership, a frequently used method to allocate earnings and principal between different mortgagees is the determination, during a specified test period, of the portion of net income attributable to different mortgage divisions. This is known as a "segregation formula."<sup>33</sup> Since it requires the allocation of expenses as well as earnings, some procedure for crediting and charging divisions with the use of equipment covered by one mortgage and used upon another division must be adopted.<sup>34</sup> In a recent case, the Seventh Circuit Court of Appeals specifically rejected a calculation of value to the user upon the basis of earnings in favor of the investment plus maintenance formula.<sup>35</sup> The court found that the former computation did not reflect the value of the equipment to the owner, that, indeed, it did not accurately reflect value to the user unless all earnings were deemed attributable to the particular equipment, and that it violated the policy of the ICC in favor of a uniform equipment charge. The court relied as analogy on the custom of independent railroads in using an equipment rental charge based on the investment plus maintenance factors.

Under Section 77 of the Bankruptcy Act,<sup>36</sup> formulas for allocating income between different claimants in railroad reorganizations may be referred to the ICC for opinion as to their fairness. In a number of cases involving compensation for the use of equipment, the Commission has taken a position similar to that of the court in the case referred to above.<sup>37</sup> It has suggested an investment plus maintenance formula, and in one case raised the percentage return from 2%, which was the return the railroad was actually earning on its property, to 4%, which it considered a fair average on equipment investments in the market.<sup>38</sup> Reliance was placed upon market rates and the practice of independent railroads.

Despite the possible objection that it does not adequately reflect value to the user—an objection which loses validity since retention of the equipment is at the instance of the user and not of the owner—the suggested investment plus maintenance formula seems practical. A formula based on earnings must be purely arbitrary in the absence of any method of allocating system earnings to particular equipment. Moreover, both the mileage and earnings tests have been implicitly and sometimes expressly rejected in railroad equipment cases holding that a receiver must compensate for retention of equipment without reference to use or benefit.<sup>39</sup> Further support for the formula is found in action taken by the independent railroads: in arranging for car hire rates, where value to the user as well as to the owner is pre-

33. For a thorough discussion of this and other formulas see Meck and Masten, *Railroad Leases and Reorganization: I* (1940) 49 YALE L. J. 626, 640 *et seq.*

34. See Meck and Masten, *supra* note 33, at 643.

35. *In re* Chicago, R. I. & P. Ry. Co., 108 F. (2d) 410 (C. C. A. 7th, 1939).

36. BANKRUPTCY ACT § 77(c)(10), 11 U. S. C. § 205(c)(10) (Supp. 1938).

37. New York, S. & W. R. R. Reorg., 236 I. C. C. 425 (1939); Denver & R. G. W. R. R. Reorg., 233 I. C. C. 515 (1939); Chicago, Ind. & L. Ry. Reorg., 228 I. C. C. 209 (1938); New York, N. H. & H. R. R. Reorg., 224 I. C. C. 723 (1938). The last case involved equipment of the lessee used on a line covered by a disaffirmed lease. The allocation problem—and the basic purpose—is the same as in the mortgage division cases.

38. Denver & R. G. W. R. R. Reorg., 233 I. C. C. 515 (1939).

39. See note 25 *supra*.



sumably considered, they abandoned the mileage basis in favor of an investment plus maintenance formula, with the approval of the ICC.<sup>40</sup>

In applying this formula the percentage rates will probably be governed by market rates of return on similar investments during the period in question, while maintenance charges may be ascertained from conservative railroad practice. The justification for such charges is the equitable duty of the court to return the equipment in as good condition as when the receivership began, or to make payments which will equalize its depreciation. The receivers will, of course, be credited with expenditures actually made by them for maintenance and repair during their tenure,<sup>41</sup> and will not be obligated to make good deficiencies in maintenance accruing before their appointment.<sup>42</sup>

The final problem is the relative priority of the equipment owner's claim. Where the receivership is at the instance of bondholders, and where the equipment is actually used, payment for its use is held to be an "operating expense" and a debt of the receivership.<sup>43</sup> The owner is therefore entitled to priority over bondholders' claims with respect not only to income but generally to the corpus as well.<sup>44</sup> Since the bondholders moved the court to take possession of the equipment and to use it to keep the road in operation and to preserve its property and franchises, their implied consent to this priority is assumed.<sup>45</sup> While necessity to the road is a basis of this rationale, the court does not generally inquire into the extent to which the equipment was actually necessary, this being regarded as peculiarly within the province of the receivers.<sup>46</sup> During the period, however, when receivership is at the instance of other creditors, it has been held that the equipment owner is en-

40. Rules for Car Hire Settlement, 160 I. C. C. 369 (1930). The change occurred in 1902.

41. In the *Florida East Coast* case the receivers presumably paid taxes and insurance, as well as \$30,000 for repairs during the five year period. They claim this was enough. Answer of Receivers, p. 6. Petitioner asserts that it was inadequate.

42. *Thomas v. Western Car Co.*, 149 U. S. 95 (1893).

43. *Union Trust Co. v. Illinois Midland Co.*, 117 U. S. 434 (1886); *Platt v. Philadelphia & R. R. R.*, 84 Fed. 535 (C. C. A. 3d, 1898); *Frank v. Denver & R. G. Ry.*, 23 Fed. 123 (C. C. Colo. 1885); *Turner v. Indianapolis, B. & W. Ry.*, 24 Fed. Cas. 372, No. 14,260 (C. C. Ind. 1879).

44. *Thomas v. Western Car Co.*, 149 U. S. 95 (1893); *Kneeland v. American Loan Co.*, 136 U. S. 89 (1890); *Union Trust Co. v. Illinois Midland Co.*, 117 U. S. 434 (1885); *Myer v. Car Co.*, 102 U. S. 1 (1880); *Hubbell v. Texas So. Ry.*, 59 Tex. Civ. App. 157 (1910), *writ of error refused*, 104 Tex. 712 (1911) (priority over both bondholders and receivers' certificates). The rule applied in the disaffirmance of leased lines—that they are operated for the account of the lessor, and the lessee cannot be charged with resulting deficits [Meck and Masten, *supra* note 33, at 659]—is not applicable to leased equipment. The leased line is also a common carrier and must be operated unless permission to abandon is obtained. If deficits accrue, the lessor would have to pay them if the lessee's receiver returned the line, and therefore the receiver should not be charged for them if he retains it. These reasons do not apply to equipment, terminals, bridges, etc., and hence the cases draw a distinction. See *North Kansas City Bridge Co. v. Lenees*, 82 F. (2d) 9, 14 (C. C. A. 8th, 1936); *Pennsylvania Steel Co. v. New York City Rys.*, 198 Fed. 721, 730 (C. C. A. 2d, 1912).

45. *Kneeland v. American Loan Co.*, 136 U. S. 89 (1890).

46. *Frank v. Denver & R. G. W. Ry.*, 23 Fed. 123 (C. C. Colo. 1885).

titled to priorities only from the income, since neither bondholders nor equipment owners have moved the court to take possession of the other's property.<sup>47</sup>

Well established law, therefore, seems to give the district court an adequate background, despite the scarcity of equipment trust disaffirmances,<sup>48</sup> against which to work out the practical application of the remedy sought. Meanwhile, its decision accepting the remedy in principle appears not only to accord with sound equitable doctrines, but also to implement the understanding of equipment trust investors, who rely on their title as assurance that, whatever happens, the railroad will not be able to retain and use their equipment without rendering compensation.

### THE MARITIME LIEN AND DAMAGES FOR WRONGFUL DISCHARGE OF FISHERMEN\*

ALTHOUGH stipulated wages are today the usual form of compensation for mariners' services, seamen are occasionally rewarded by a share in the profits of an adventure. Used largely in fishing voyages, this share, or "fishing lay,"<sup>1</sup> is considered by the courts to be substantially the same as wages. Therefore, on the analogy of the wage lien of merchant seamen,<sup>2</sup> fishermen commonly have a lien for their shares in the voyage.<sup>3</sup> The lien

47. *Kneeland v. American Loan Co.*, 136 U. S. 89 (1890).

48. Up to 1924, Duncan reports only two instances of disaffirmance of a standard equipment trust lease where certificates were in the hands of the public. *DUNCAN, op. cit. supra* note 1, 22. Some of the additional cases cited in this Note are instances where the trust obligations were in the hands of vendors, not the public.

\**Old Point Fish Co. v. Haywood*, 109 F. (2d) 703 (C. C. A. 4th, 1940).

1. For a common type of sharing agreement, the "quarter lay," see *The Georgiana*, 245 Fed. 321 (C. C. A. 1st, 1917). Only expenses clearly agreed upon may be deducted from the catch. *Goodrich v. The Domingo*, 10 Fed. Cas. 605, No. 5,543 (D. Cal. 1870). The seamen have no property in the catch itself, but only in the proceeds from its sale. *Lewis v. Chadbourne*, 54 Me. 484 (1865) (mackerel); *Jay v. Almy*, 13 Fed. Cas. 387, No. 7,236 (C. C. D. Mass. 1846) (whaling). The sharesmen are not considered partners, nor are they part owners of the fish caught. *The Mettacomet*, 230 Fed. 308 (D. Mass. 1915); *Crowell v. Knight*, 6 Fed. Cas. 910, No. 3,445 (D. Mass. 1874). For a general discussion, see *The Elk*, 1938 Am. Mar. Cas. 714 (D. Mass. 1938); *The Carrier Dove*, 93 Fed. 978 (D. Mass. 1899); *ROBINSON, ADMIRALTY* (1939) 281; 1 *BENEDICT, ADMIRALTY* (5th ed. 1925) 129.

2. For a history of the maritime lien, see *The Young Mechanic*, 30 Fed. Cas. 873, No. 18,180 (C. C. D. Me. 1855); *The Nestor*, 18 Fed. Cas. 9, No. 10,126 (C. C. D. Me. 1831); *Beach, Relative Priority of Maritime Liens* (1924) 33 *YALE L. J.* 841; *Comment* (1915) 15 *COL. L. REV.* 343. Seamen have from early days had a lien on the vessel for their wages. *ROBINSON, ADMIRALTY* (1939) 369; 1 *BENEDICT, ADMIRALTY* (5th ed. 1925) 128. And fishermen hired for stipulated wages have a lien. *The Virginia Belle*, 204 Fed. 692 (E. D. Va. 1913); *The Minna*, 11 Fed. 759 (E. D. Mich. 1882).

3. For the purpose of recovering their shares, fishermen are generally considered to be hired seamen who are paid a contingent wage. Thus the share, like seamen's wages,

for wages, which is the first to be satisfied from the proceeds of judicial sale,<sup>4</sup> is extended to compensation for wrongful discharge, the damages being fixed by statute in certain cases<sup>5</sup> at one month's wages. Sharing agreements, however, with the exception of certain types of written contracts, are governed only by general maritime law;<sup>6</sup> no statute binds the courts in awarding damages for discharge. Hence where a fisherman, sailing on shares, is wrongfully discharged before the completion of his voyage, he is generally granted a lien for his full share in the total catch,<sup>7</sup> rather than merely for such fraction of his share as accumulated while he was actually on board. The "unearned" part of his share is compensation for the wrong done him.<sup>8</sup>

An unusual case of wrongful discharge of share lien fishermen was recently presented to the Fourth Circuit Court of Appeals.<sup>9</sup> Seven fishermen, including the master, had set out from Hampton, Virginia, under an oral agreement to work a trawler on a lay. After several days, during which some \$200 worth of fish were caught,<sup>10</sup> the vessel developed engine trouble and was towed into port for repairs. Shortly thereafter, while still at the dock, the

---

is protected by a maritime lien, and may be recovered by the usual in rem proceeding against the vessel. *The Georgiana*, 245 Fed. 321 (C. C. A. 1st, 1917); *Welch v. Fallon*, 181 Fed. 875 (D. Mass. 1909); *The Carrier Dove*, 93 Fed. 978 (D. Mass. 1899).

4. *Clifford v. Merritt-Chapman and Scott Corp.*, 57 F. (2d) 1021 (C. C. A. 5th, 1932); *Butler v. Ellis*, 45 F. (2d) 951 (C. C. A. 4th, 1930); *The William Leishear*, 21 F. (2d) 862 (D. Md. 1927); *ROBINSON, ADMIRALTY* (1939) 422.

5. REV. STAT. § 4527 (1875), 46 U. S. C. § 594 (1934). This statute only applies if the discharge occurs before commencement of the voyage, or before one month's wages have been earned. Not a punishment for the master, but a well-defined rule of damages, the statute was intended to afford seamen "a simple, summary method of establishing and enforcing damages." *The Steel Trader*, 275 U. S. 388, 390 (1928). For similar provisions compensating the seaman for delay in the payment of his wages, see REV. STAT. § 4529 (1875), 46 U. S. C. § 596 (1934).

6. By 18 STAT. 64 (1874), 46 U. S. C. § 544 (1934), the statute cited *supra* note 5 is made inapplicable to "any case where the seamen are by custom or agreement entitled to participate in the profits or result of a cruise, or voyage." Certain types of cod and mackerel voyages are, however, governed by statute. In each case the agreement between master and crew must be written and signed. REV. STAT. § 4391 (1875), 46 U. S. C. § 531 (1934). Fishermen sailing under such agreements have a lien against the vessel for their shares. REV. STAT. § 4393 (1875), 46 U. S. C. § 533 (1934). But these fishery statutes, like the statutes regulating merchant seamen, are strictly construed. *The ZR-3*, 18 F. (2d) 122 (W. D. Wash. 1927) (no application where wages instead of shares). Shipping on a lay, on an oral agreement, and on terms different from those set out in REV. STAT. §§ 4391-3, leaves to the fishermen the rights ordinarily accorded by law. *The American Beauty*, 295 Fed. 513 (W. D. Wash. 1924); *The Cornelia M. Kingsland*, 25 Fed. 856 (S. D. N. Y. 1885).

7. See Note 24, *infra*.

8. *The American Beauty*, 295 Fed. 513, 516 (W. D. Wash. 1924).

9. *Old Point Fish Co. v. Haywood*, 109 F. (2d) 703 (C. C. A. 4th, 1940) (Judge Parker dissenting).

10. The arrangement in substance provided that the crew would furnish fuel, ice and food, and receive 60% of the gross proceeds of the catch. The remaining 40% were to go to the ship owner, who furnished the boat and tackle. The fish actually caught were of so little value as to fall below the cost of the oil and food provided by the crew.

trawler was libeled for an old repair bill; whereupon numerous other creditors intervened to enforce similar claims, the total indebtedness amounting to more than \$16,000. Five of the crew, discharged by this arrest without their consent, filed intervening libels, claiming roughly \$1000 each — their estimated shares from a completed voyage — as damages for breach of contract of employment. The vessel was sold for less than \$6000. The fish actually caught constituted so minute a fraction of the usual season's catch as to afford the district court no direct basis for assessing the damages. Without a full catch from which to compute full lays, the district court, by analogy to the merchant seamen damage statute,<sup>11</sup> awarded four of the men a lien for \$100 each, their average monthly earnings on similar voyages in the past.<sup>12</sup>

The circuit court, pointing out that the statute does not apply to agreements providing for a share in the profits of a voyage, disallowed the award on appeal. The decision of the court was based on two grounds: first, that liens do not exist for damages consequential upon arrest of the vessel; second, that the maritime lien, being secret and acting to the prejudice of general creditors and purchasers without notice, is *stricti juris*<sup>13</sup> and would not be extended by analogy or inference. In commenting on the actual award of one month's "wages," the court noted that, while stipulated wages form a calculable basis for damages, the amount in this case was "too speculative" to be estimated.

One basis for the court's opinion — that the admiralty law does not allow a prior lien for damages consequential upon a legal arrest of a vessel — is open to varied interpretations. The court seemingly employed the doctrine as a general statement of the rule that no lien attaches for services rendered to a vessel in *custodia legis*.<sup>14</sup> But this rule seems inapplicable to the instant

11. REV. STAT. § 4527 (1875), 46 U. S. C. § 594 (1934). Since the discharge occurred within one month of the start of the voyage, the situation in the instant case is analogous in this respect to those covered by the statute.

12. The district court found that, without their fault, and as a result of the owner's indebtedness, the fishermen would probably be unable to obtain similar employment at this advanced date in the season, and that the statute furnished a fair standard by which to adjudge their claims. Brief for Appellants, p. 4½.

13. See *Piedmont and Georges Creek Coal Co. v. Seaboard Fisheries Co.*, 254 U. S. 1, 12 (1920); *Vandewater v. Mills*, 19 How. 82, 89 (U. S. 1857). The *stricti juris* rule is a convenient instrument by which the courts can refuse to recognize the existence of a lien. A court that applies the rule will in the same opinion point out that a lien will be found, by analogy, where "changing conditions of human activity" require it. The *Neptune*, 277 Fed. 230, 231 (C. C. A. 2d, 1921). Whether or not to recognize a new lien seems, therefore, to depend for its answer upon the equities of the case. See also 1 BENEDICT, ADMIRALTY (5th ed. 1925) 19, 95.

14. It has ordinarily been held that events subsequent to the legal seizure of a vessel do not give rise to liens against her while she remains in *custodia legis*. See *Collie v. Fergusson*, 281 U. S. 52, 55 (1930). Thus no lien attaches for wages due for services rendered to the vessel after her seizure. The *Bethlehem*, 286 Fed. 400 (E. D. Pa. 1923); The *Nisseqogue*, 280 Fed. 174 (E. D. N. C. 1922). But the crew obtain their compensation for wrongful discharge, under REV. STAT. § 4527 (1875), 46 U. S. C. § 594 (1934). The *Astoria*, 281 Fed. 618 (C. C. A. 5th, 1922). See ROBINSON, ADMIRALTY (1939) 366.

case.<sup>15</sup> Damages for wrongful discharge are never granted for services after discharge, as such services are never in fact rendered. A lien does exist, however, not for services, but as compensation for the loss occasioned by the wrongful act of the owner, which in this case consisted in permitting the legal arrest to end the voyage. If, on the other hand, the court means that the libeling of a vessel, with consequent termination of the voyage, is not considered the legal equivalent of a wrongful discharge, it would seem to be in error.<sup>16</sup> Discharge of a seaman in consequence of the judicial sale of a vessel is regarded as the act of the owner, leaving the vessel liable to the seaman to the same extent the owner would be.<sup>17</sup> Where the damage statute does not govern, it has been held that the owner, in permitting the vessel to be sold for his debt, violates his contract with the seamen,<sup>18</sup> and that it is the owner's duty to give a bond and continue the voyage.<sup>19</sup> Moreover, where the statute does govern, legal arrest of the vessel generally breaks up the voyage and gives the usual statutory lien for damages.<sup>20</sup>

In opposing extension of the maritime lien into new fields, the court in this case was following orthodox admiralty doctrine.<sup>21</sup> Statutes creating such liens are strictly construed,<sup>22</sup> and courts will rarely recognize the existence

15. The fact that libelants sought as damages the earnings which would have accrued after seizure of the vessel by the marshal may have obscured the true nature of the action in the instant case. The court's confusion seems to have arisen out of the similarity between the methods employed in calculating the award for wrongful discharge and that for services rendered to a vessel *in custodia legis*. In both situations the basis for calculation lies in the period subsequent to legal arrest. Due to this confusion, perhaps, the court refused to grant a lien; a lien is granted for damages for discharge, but not for services to an arrested vessel.

16. Seizure of the vessel by the marshal puts an end to the voyage, entitling seamen to damages for wrongful discharge under Rev. Stat. § 4527 (1875), 46 U. S. C. § 594 (1934). *The Great Canton*, 299 Fed. 953 (E. D. N. Y. 1924); *The Astoria*, 281 Fed. 618 (C. C. A. 5th, 1922). Subsequent intervention by the seamen does not constitute a waiver of their right to damages for such discharge, since their act in libeling the vessel is merely an election to treat their engagement as put to an end by the owner's abandonment of the vessel. *The Charles L. Baylis*, 25 Fed. 862 (S. D. N. Y. 1885); see *The Nissequogue*, 280 Fed. 174, 184 (E. D. N. C. 1922); *The Esteban de Antunano*, 31 Fed. 920, 925 (C. C. E. D. La. 1887).

17. *The Hudson*, 12 Fed. Cas. 805, 806, No. 6,831 (S. D. N. Y. 1846). Although the discharge was there effected by a third party, the seizure of the vessel has itself been held to operate as a wrongful discharge of the crew. *The Esteban de Antunano*, 31 Fed. 920, 925 (C. C. E. D. La. 1887); *Woolf v. The Oder*, 30 Fed. Cas. 600, No. 18,027 (D. Pa. 1802); see *Wells v. Osmond*, 6 Mod. 238, 87 E. R. 987 (K. B. 1705).

18. "The voyage has been broken up by the fault of the owner, as he permitted the vessel to be sold for his debt. This was a violation of his contract with the libellants, for which they have a right to recover a full indemnity." *The Gazelle*, 10 Fed. Cas. 127, 128, No. 5,289 (D. Mass. 1858). *Contra*: *The Frank and Willie*, 45 Fed. 488 (S. D. N. Y. 1891).

19. *Van Beuren v. Wilson*, 9 Cow. 158 (N. Y. 1828).

20. See note 16 *supra*.

21. See note 13 *supra*.

22. See note 6 *supra*. An interesting example of strict construction is afforded by decisions under the FEDERAL MARITIME LIEN ACT OF 1910, 36 STAT. 604 (1910), now

of new liens by analogy. This restrictive treatment has, however, largely developed in cases involving the rights of materialmen or repairmen.<sup>23</sup> Seamen have always been in a privileged position under the general maritime law, and, prior to the enactment of the statutes governing wrongful discharge, courts granted liens for damages covering such discharge<sup>24</sup> and exercised broad discretion in assessing the compensation to be awarded.<sup>25</sup> When statutes fixing a definite compensation were enacted, judicial freedom was restricted in situations where they applied.<sup>26</sup> Where they did not apply directly—and statutes relating to seamen and fishermen are strictly construed in their direct application,<sup>27</sup>—the courts retained possession of the discretionary powers which they had previously exercised.<sup>28</sup> There is, therefore, no attempt to extend the maritime lien in this case. Where no statute governs, it is difficult to understand why the courts may not continue to grant damage liens in the familiar manner, and in the exercise of discretion utilize the statutes as a guide or standard. The rule of strict construction would not be contravened so long as the statute were not held to apply directly; yet the customary policy of leniency toward seamen<sup>29</sup> would thereby be satisfactorily observed.

merged in 41 STAT. 1005 (1920), 46 U. S. C. § 971 *et seq.* (1934). The *J. Doherty*, 207 Fed. 997 (S. D. N. Y. 1913); ROBINSON, ADMIRALTY (1st ed. 1939) 373.

23. *Piedmont and Georges Creek Coal Co. v. Seaboard Fisheries Co.*, 254 U. S. 1 (1920); *The Suelco*, 286 Fed. 286 (D. N. Y. 1923); *The Muskegon*, 275 Fed. 348 (C. C. A. 2d, 1921). But *cf.* *The Artemis*, 53 F. (2d) 672 (S. D. N. Y. 1931). Yet in the case of seamen a maritime lien for personal injuries arising from unseaworthiness, etc., has not been extended despite the convenient analogy afforded by the Jones Act. *Plamais v. Pinar del Rio*, 277 U. S. 151 (1928). But see *The State of Maryland*, 85 F. (2d) 944 (C. C. A. 4th, 1936); Note (1937) 37 COL. L. REV. 480.

24. Where fishermen sailing on shares are wrongfully discharged before the voyage would normally have ended, they have a lien on the vessel for their full share, including that part which accrued, or would have accrued, after such discharge. *The American Beauty*, 295 Fed. 513 (W. D. Wash. 1924) (voyage continued after discharge); *The Page*, 18 Fed. Cas. 977, No. 10,660 (D. Cal. 1878) (voyage abandoned); *The Hibernia*, 12 Fed. Cas. 112, No. 6,455 (D. Mass. 1844) (voyage continued).

25. Courts have generally stated that they are free to award damages for wrongful discharge in accordance with the equities of the case. *McKenzie v. The Oglethorpe*, 16 Fed. Cas. 204, 206, No. 8,857 (S. D. N. Y. 1841); *Hindman v. Shaw*, 12 Fed. Cas. 200, No. 6,514 (D. Pa. 1806); *Woolf v. The Oder*, 30 Fed. Cas. 600, No. 18,027 (D. Pa. 1802); *Thompson v. The Oakland*, 23 Fed. Cas. 1064, 1065, No. 13,971 (D. Mass. 1841).

26. Where the statute applies, no more than one month's wages may be awarded as damages, for it prescribes an exclusive remedy. *The Steel Trader*, 275 U. S. 388 (1928), 23 ILL. L. REV. 292. The statute is, however, strictly construed in its direct application. *The Golden Kauri*, 28 F. Supp. 288 (E. D. La. 1939) (seaman discharged *after* one month). See notes 6, 22 *supra*.

27. See notes 6, 22 *supra*.

28. See *The American Beauty*, 295 Fed. 513, 516 (W. D. Wash. 1924).

29. "Sailors are indulged in courts of admiralty." *Clifford v. Merritt-Chapman and Scott Corp.*, 57 F. (2d) 1021, 1024 (C. C. A. 5th, 1932). There are innumerable examples of this leniency to seamen. *Goodrich v. The Domingo*, 10 Fed. Cas. 605, No. 5,543 (D. Cal. 1870); *Hussey v. Fields*, 12 Fed. Cas. 1061, No. 6,947 (D. Mass. 1858); *The M. M. Morrill*, 78 Fed. 509 (D. Wash. 1897); *Dexter v. Munroe*, 7 Fed. Cas. 616, No. 3,863 (D. Mass. 1861). This leniency and justice extends to awards of damages for wrongful

In view of the equitable approach often used by courts of admiralty,<sup>30</sup> the use of the statute as a "fair standard" would appear proper under the peculiar circumstances of this case.

If a lien be granted, difficulties arise in computing the amount thereof. By accepted damage standards, the wrongful discharge award is considered compensation for loss of earning power.<sup>31</sup> Before the statutes prescribed such damages, courts ordinarily granted wages for the time reasonably consumed by a return voyage to the original port of shipment, deducting from this amount whatever the seamen actually earned from other employment during that period.<sup>32</sup> The presumption was that he could easily obtain new employment in his home port.<sup>33</sup> Since, on the other hand, fishermen could find employment only at certain times of the year, their loss of earning power was greater. Courts, therefore, customarily awarded them a full lay, regardless of the length of time a return voyage might require.<sup>34</sup>

One important factor, however, distinguished this case from the usual situation—no full catch existed from which the damages could be estimated, making any amount awarded purely speculative. But this difficulty seems to be of a purely mechanical nature. When hypothetical full catches have previously been calculated from actual catches, there has never been so brief a period from which to reckon.<sup>35</sup> Furthermore, although it is possible to

---

discharge. *Emerson v. Howland*, 8 Fed. Cas. 634, No. 4,441 (C. C. D. Mass. 1816). And to awards for wages. *The James H. Shrigley*, 50 Fed. 287 (N. D. N. Y. 1892).

30. Courts of admiralty apply equitable principles to the distribution of funds in their possession. *United States v. Cornell Steamboat Co.*, 202 U. S. 184, 194 (1906). See *O'Brien v. Miller*, 168 U. S. 287, 297 (1897); *August Honerkamp Lumber Co. v. Steves Lumber and Building Co.*, 95 F. (2d) 593, 596 (C. C. A. 5th, 1938).

31. For a good discussion of the nature of damages for wrongful discharge, see the opinion of Judge Story in *Emerson v. Howland*, 8 Fed. Cas. 634, No. 4441 (C. C. D. Mass. 1816).

32. For examples of the various awards in wrongful discharge situations, see *The Artisan*, 2 Fed. Cas. 3, No. 563 (E. D. N. Y. 1877) (discharge before voyage; voyage abandoned); *The Acorn*, 32 Fed. 638 (W. D. Pa. 1887) (discharge before voyage; voyage prosecuted); *Baton Rouge and B. S. Packet Co. v. George*, 128 Fed. 914 (C. C. A. 5th, 1904) (discharge during voyage; voyage abandoned); *The Gazelle*, 10 Fed. Cas. 127, No. 5,289 (D. Mass. 1858) (voyage ended by legal arrest); *The Maria*, 16 Fed. Cas. 725, No. 9,074 (S. D. N. Y. 1832) (discharge during voyage; voyage continues). Where the seamen were paid in shares rather than wages: *The Page*, 18 Fed. Cas. 977, No. 10,660 (D. Cal. 1878) (hypothetical full share); *Mahoon v. The Gloucester*, 16 Fed. Cas. 499, No. 8,970 (Admiralty Court, Pa. 1780) (full share); *The American Beauty*, 295 Fed. 513 (W. D. Wash. 1924) (full share, less earnings from other employment); see *The Paul L.*, 4 F. Supp. 537 (W. D. Wash. 1933).

33. *Emerson v. Howland*, 8 Fed. Cas. 634, 637 (C. C. D. Mass. 1816).

34. See note 32 *supra*.

35. The only case in point seems to be *The Page*, 18 Fed. Cas. 977, No. 10,660 (D. Cal. 1878), where the voyage was wrongfully abandoned when half over. The court calculated a hypothetical full catch by doubling what each man had caught. For somewhat similar "speculation," see *The Paul L.*, 4 F. Supp. 537 (W. D. Wash. 1933). The contrary result is reached by a variety of paths. *The Mettacomet*, 230 Fed. 308 (D. Mass. 1915) (no express agreement covering failure to catch enough fish); *The General McPherson*, 100 Fed. 860 (D. Wash. 1900) (nothing liquidated due); *The Fair Play*, 8 Fed. Cas.

multiply the fish caught by a time-factor, in the instant case the time spent on the water was so short as to raise doubts with regard to its value as a typical period. The actual daily catch in all probability deviated considerably from the average for a completed trip. Data as to former voyages may, however, be used in calculating damages, where other evidence is insufficient.<sup>36</sup> Under the circumstances, the district court chose to find in the evidence of past earnings a basis for computing a fair monthly wage, and granted a lien for that sum on the analogy of the statute granting merchant seamen wrongful discharge damages of one month's wages.

In view of the almost identical nature of wages and shares and the impracticability of using the actual catch as a basis for estimating a hypothetical full one, the district court's use of the statute as a fair standard for assessing damages seems a proper and equitable course. The decision of the circuit court, in contrast, not only disregards settled maritime law by refusing a lien, but also indicates a disposition to restrict the flexible determination of damages in a sphere where judicial discretion has hitherto been unhampered.<sup>37</sup>

## THE POWER TO INVADE CORPUS IN FEDERAL INCOME TAXATION OF TRUSTS\*

IN providing for federal taxation of trust income Congress clearly intended that, although non-exempt income should be taxed but once, no income should escape taxation unless definitely exempt.<sup>1</sup> Section 162(b) allows a trustee to deduct from net income "the amount of the income of the estate or trust for its taxable year which is to be distributed currently by the fiduciary to the beneficiaries," but provides that "the amount so allowed as a deduction shall be included in computing the net income of the beneficiaries."<sup>2</sup> In view

957, No. 4,615 (S. D. N. Y. 1830) (admiralty cannot grant accounting); *Williams v. The Sylph*, 29 Fed. Cas. 1407, No. 17,740 (S. D. N. Y. 1841). Some of these arguments seem to revert to the limited jurisdiction of the High Court of Admiralty. Simple accountings have been granted in admiralty. *The I. S. E. 2*, 15 F. (2d) 749 (C. C. A. 9th, 1926); *The Carrier Dove*, 93 Fed. 978 (D. Mass. 1899).

36. *The Paul L.*, 4 F. Supp. 537, 540 (W. D. Wash. 1933) (alternative holding).

37. Although the libelants in the instant case would have had an action *in personam* against the shipowner for breach of contract, his insolvency rendered such remedy useless. See *Baton Rouge and B. S. Packet Co. v. George*, 128 Fed. 914 (C. C. A. 5th, 1904); *Nevitt v. Clarke*, 18 Fed. Cas. 29, No. 10,138 (S. D. N. Y. 1846); *Jay v. Almy*, 13 Fed. Cas. 387, No. 7,236 (C. C. D. Mass. 1846).

\**Estate of Edward T. Bedford*, 39 B. T. A. 1039 (1939), *appeal dismissed*, 4 Prentice-Hall 1940 Fed. Tax Serv. ¶61,024 (C. C. A. 2d, 1940).

1. *Helvering v. Butterworth*, 290 U. S. 365 (1933); *Estate of Edward T. Bedford*, 39 B. T. A. 1039 (1939); 61 CONG. REC. 7112 (1921).

2. INT. REV. CODE §162(b) (1939). During estate administration, and where in the fiduciary's discretion income is distributed or accumulated, § 162(c) allows him deduction for income which is properly paid or credited. For similar provisions see N. Y. TAX



of the wording of the statute, the Supreme Court's holding in *Irwin v. Gavit* that a bequest of trust income *only* is annually taxable to the beneficiary as income from a bequest, rather than entirely exempt from income tax as a bequest,<sup>3</sup> accords with the Congressional purpose of taxing the recipient and granting the trustee a deduction. At the same time, it represents a definite encroachment upon the exemption usually accorded bequests. In *Burnet v. Whitehouse*, involving a bequest of fixed annual sums to be paid from income if sufficient but from corpus if necessary, the Court refused to follow the lead of the *Irwin* case. It held, rather, that the threat of corpus invasion rendered the entire payment exempt as a bequest, even though in fact the entire payment was made from income.<sup>4</sup>

This decision immediately raised the issue of taxability of the trustee: to permit the trustee a deduction for income distributed would leave the income entirely untaxed. *Helvering v. Pardee* denied the deduction, holding that the "payments . . . were not distribution of income; but in discharge of a gift or legacy. The principle applied in *Burnet v. Whitehouse* . . . is not applicable."<sup>5</sup> The trustee's deduction under Section 162(b) of payments of trust income was thus apparently conditioned upon the taxability of the income to the beneficiary.<sup>6</sup>

---

LAW § 365; KY. STAT. ANN. (Carroll, 1936) § 4281b-29; N. M. STAT. ANN. (Court-right, Supp. 1938) § 141-1527. See generally Rosenbloom, *Federal Income Tax on Decedents' Estates During Period of Administration* (1938) 12 TEMP. L. Q. 149.

3. 268 U. S. 161 (1925). INT. REV. CODE § 22(b)(3) (1939) excludes from gross income gifts and bequests but not the income therefrom. "The language quoted leaves no doubt in our minds that if a fund were given to trustees for A for life with remainder over, the income received by the trustees and paid over to A would be income of A under the statute. It seems to us hardly less clear that even if there were a specific provision that A should have no interest in the corpus, the payments would be income none the less . . ." *Id.* at 167. See MAGILL, TAXABLE INCOME (1936) 381. The argument of the dissent that the money here sought to be taxed was not the fruits of a legacy, but was the legacy itself, is at least as convincing.

4. 283 U. S. 148 (1931). The threat of corpus invasion is determinative although provision has been made for replenishment of corpus from subsequent income [James R. Duncan, 34 B. T. A. 999 (1936), *aff'd*, 91 F. (2d) 1012 (C. C. A. 2d, 1937)], or by remaindermen [Bay Trust Co., Trustee, 34 B. T. A. 233 (1936)].

5. 290 U. S. 365, 370 (1933).

6. The decision obviated contemplated amendments to § 162(b) and (c) providing deduction *only if* taxed to the beneficiary. H. R. REP., Ways and Means Subcommittee, 73d Cong., 2d Sess. (Dec. 4, 1933—seven days prior to *Helvering v. Pardee*); SEIDMAN'S LEGISLATIVE HISTORY OF FEDERAL INCOME TAX LAWS (1938) 380.

These cases have sometimes loosely been cited as holding that to permit a deduction, income must be distributed *as such*, and not as a fixed annuity. *E.g.*, *Marie Minor Sanborn*, 33 B. T. A. 1120, 1124 (1936), *aff'd*, 88 F. (2d) 134 (C. C. A. 8th, 1937). If this, rather than taxability to the recipient, were the test, where a settlor of a charitable inter vivos trust reserves to himself fixed annual payments the trustee would be denied deduction. But since the gift and bequest exemptions do not apply here to the fixed payments, the settlor, too, is taxed on their receipt, generally under § 22(b)(2) as an annuity, *Anna L. Raymond*, 40 B. T. A. No. 45, July 20, 1939. The tax to the settlor would properly be based on the full payment since the return of capital of a commercial

The principles established in these cases have not been carried over intact to the closely related Section 162(a) which allows a deduction to the trustee of "any part of the gross income,"<sup>7</sup> without limitation, which pursuant to the terms of the will or deed creating the trust, is during the year paid or permanently set aside" for charitable purposes. In a recent case the testator provided for the maintenance of certain public gardens, the trust corpus to be invaded if net income proved insufficient.<sup>8</sup> Reasoning that these payments were annuities and therefore tax-free bequests under *Burnet v. Whitehouse*, the Commissioner relied on the *Pardee* case to deny the trustee deductions for the amounts paid out of income, although he conceded their charitable nature. The Board of Tax Appeals, however, supported the trustee and held that deductions under Section 162(a) were granted pursuant to an exemption fostering charitable donations; unlike those in Section 162(b) and despite cases such as *Helvering v. Pardee* arising thereunder, they did not depend upon taxability to the recipient.

To be compared with the Board's disregard of the power to invade corpus as a factor in this type of charitable case is the attitude taken in other types of cases under Section 162(a). Where the testator establishes a trust for a charitable institution but directs that fixed annuities be paid to certain individuals out of trust income, or corpus if necessary, the issue arises whether surplus income or capital gains<sup>9</sup> are deductible by the trustee as "permanently set aside" to the charitable remainderman, although subject to possible recovery if future income proves inadequate.<sup>10</sup> A few opinions have adopted the uncompromising view of the *Whitehouse* case that the mere threat of

---

annuity is not here contemplated. Comment (1935) 44 YALE L. J. 660; Note (1939) 34 ILL. L. REV. 348. The resultant double taxation would be contrary to the purpose of § 162. See § 3801(b) (4) reference to "correlative" inclusion or deduction under § 162(b) and (c).

7. Since 1937 the Treasury has directed treatment "as shares of beneficiaries [deducted from *net* income under § 162(b)], amounts of charitable contributions . . . paid or permanently set aside as provided in Section 162(a)." Charles F. Grey, 41 B. T. A. No. 37, Jan. 31, 1940, held this resulted in partial denial of the deduction, which should be made directly from *gross* income.

8. Estate of Edward T. Bedford, 39 B. T. A. 1039 (1939), *appeal dism'd*, 4 Prentice-Hall 1940 Fed. Tax Serv. ¶ 61,024 (C. C. A. 2d, 1940).

9. In *Hartford-Conn. Trust Co. v. Eaton*, 8 F. Supp. 218 (D. C. Conn. 1934) the wife had the income for life with power to invade the corpus for her comfortable support" of an individual [*Hartford-Conn. Trust Co. v. Eaton*, 36 F. (2d) 710 (C. C. A. because, being charged on corpus, it was paid from corpus, leaving the full income "set aside" for charity. The rationale seems questionable. Cf. *F. G. Bonfils Trust*, 40 B. T. A. No. 167, Dec. 8, 1939.

10. The issue is presented in a variety of forms: (1) provision for the "comfortable support" of an individual [*Hartford-Conn. Trust Co. v. Eaton*, 36 F. (2d) 710 (C. C. A. 2d, 1929); *Charles P. Moorman Home for Women v. United States*, 42 F. (2d) 257 (W. D. Ky. 1930) (income accumulations only)]; (2) where the charity is *residual* remainderman after individual remaindermen receive fixed amounts [*Gertrude Hemler Tracy*, 30 B. T. A. 1156 (1934)] or an undetermined amount [*Charles W. Jaynes*, 29 B. T. A. 259 (1933)].

invasion, however remote, precludes deduction.<sup>11</sup> But, drawing on parallel cases arising under the estate tax,<sup>12</sup> the courts have generally taken a more realistic view. They have allowed the deduction where the expectancy of an ample, continuing income dispels the threat of invasion,<sup>13</sup> and have denied it where the margin is narrow and the prospects uncertain.<sup>14</sup> Nevertheless, had the trustees in these cases attempted to deduct under Section 162(b) the fixed amounts paid to annuitants, the deductions would have been denied under the *Pardee* case.

The curious contrast of denying the trustee a deduction for income paid to annuitants because of the bare threat of corpus invasion, while granting deduction for the remaining income set aside for charity because of the remoteness of that threat, suggests reconsideration of the effect to be accorded to the presence of a power to invade corpus. The rule of *Burnet v. Whitehouse* has frequently been criticized for adopting as the test of income "not the common understanding of the term, nor even the actual source of the payment, but rather the remotely possible source."<sup>15</sup> It may also be criticized as a device for tax avoidance. The settlor, by inserting in the trust instrument a power to invade corpus (even though the prospect of invasion is remote) shifts the burden of taxation to a trustee; multiplication of trusts reduces surtax rates. Consequently, attempts to justify the case in terms of the settlor's intent are at once question-begging and unrealistic.<sup>16</sup> It is true, of

11. *Charles P. Moorman Home for Women v. United States*, 42 F. (2d) 257 (W. D. Ky. 1930); see *Guaranty Trust Co. of N. Y., Ex'r*, 31 B. T. A. 19, 22 (1934), *aff'd*, 76 F. (2d) 1010 (C. C. A. 2d, 1935).

12. *Ithaca Trust Co. v. United States*, 279 U. S. 151 (1929). The issue is whether the power to invade corpus renders corpus gifts to charity too uncertain to be exempt. With adequate income, said Mr. Justice Holmes, "there was no uncertainty appreciably greater than the general uncertainty that attends human affairs." *Id.* at 154. *Humphrey v. Millard*, 79 F. (2d) 107 (C. C. A. 2d, 1935).

13. *Capital gains: Hartford-Conn. Trust Co. v. Eaton*, 36 F. (2d) 710 (C. C. A. 2d, 1929); *Hartford-Conn. Trust Co. v. Eaton*, 41 F. (2d) 69 (D. Conn. 1930); *Helen G. Bonfils, Ex'r*, 40 B. T. A. No. 166, Dec. 8, 1939. *Surplus income: Hartford Nat'l Bank & Trust Co. v. Hartford-Conn. Trust Co.*, 20 Am. Fed. Tax R. 1325 (D. Conn. 1937).

But since litigation may be required to establish the sufficiency of the income, draftsmen should carefully weigh the insertion of a power to invade corpus.

14. *Boston Safe Deposit & Trust Co. v. Comm'r*, 66 F. (2d) 179 (C. C. A. 1st, 1933), *cert. denied*, 290 U. S. 700 (1933) (surplus income) criticizes *Hartford-Conn. Trust Co. v. Eaton*, 29 F. (2d) 840 (D. Conn. 1928) (holding that until the power to invade corpus actually was exercised, capital gains were "set aside" to charity), *aff'd*, 36 F. (2d) 710 (C. C. A. 2d, 1929) (but on ground threat was remote).

15. MAGILL, *TAXABLE INCOME* (1936) 383. See also Comment (1935) 44 *YALE L. J.* 660; Notes (1931) 31 *COL. L. REV.* 1053, (1934) 34 *COL. L. REV.* 183.

16. All the cases are justified and reconciled upon a presumed intent of the parties as to the incidence of tax in Comment (1934) 82 *U. OF PA. L. REV.* 747. But it seems undesirable that tax law interpretation should be governed by taxpayer's whim, especially when motivated by tax reduction. Compare *Congdon v. Comm'r*, 99 F. (2d) 318 (C. C. A. 8th, 1938) wherein the court implied a power to invade corpus, thereby shifting the tax to the trustee.

course, that the *Whitehouse* rule has long enjoyed nearly universal recognition by the courts;<sup>17</sup> nevertheless, it has sometimes been overlooked,<sup>18</sup> has not always been endorsed by the Commissioner,<sup>19</sup> and occasionally has been avoided in decisions.<sup>20</sup> In view of Congressional acquiescence,<sup>21</sup> however, its reconsideration probably calls for legislative action.

Action upon reconsideration might take several forms. One possibility is statutory reversal of *Irwin v. Gavit* to exempt the legatee from income taxation on bequests of income. Such legislation would dismiss the unwonted emphasis placed by the *Whitehouse* rule upon the threat of corpus invasion, and restore the bequest exemption to its full vigor.<sup>22</sup> A more extreme alternative, suggested by the fact that the distinction in the *Whitehouse* case was drawn to preserve the income tax exemption of gifts and bequests, is abolition of this exemption.<sup>23</sup> Short of such far-reaching action, however, payments should be taxed according to their *actual* and not their *possible* source. They should be taxed to the beneficiary<sup>24</sup> and deducted by the trustee to the extent

17. *Accord*: People *ex rel.* Duncan v. Graves, 257 App. Div. 552, 13 N. Y. Supp. (2d) 608 (3d Dep't 1939), under New York law, *supra* note 2. See also U. S. Treas. Reg. 103 § 19.22(a)-12 (annuities charged on land); Benfield v. United States, 27 F. Supp. 56 (Ct. Cl. 1939) (a will compromise); Murray Brookman, 41 B. T. A. No. 82, March 7, 1940 (an alimony trust); Paul, *Five Years with Douglas v. Willcuts* (1939) 53 HARV. L. REV. 1, 12, n. 31.

18. In Hartford Nat'l Bank & Trust Co. v. Hartford-Conn. Trust Co., 20 Am. Fed. Tax R. 1325 (D. Conn. 1937), litigating § 162(a), deduction taken by the trustee under § 162(b) for annuity payments was apparently overlooked. In J. Edward Johnston, 41 B. T. A. No. 81, March 6, 1940, the beneficiary reported such payments as income. See Peoples Trust Co., Trustee, 10 B. T. A. 1385 (1928). Instructions with Form 1041 (1939) fail to mention the distinction between annuities and gifts of income, but trust instruments must be filed with the Treasury Department.

19. Bay Trust Co., Trustee, 34 B. T. A. 233 (1936). Advantage to the revenue depends upon surtax rates of trustee and beneficiary. See Comment (1935) 44 YALE L. J. 660, 666 (fairer to use beneficiary's rate).

20. John K. Howard, Trustee, 34 B. T. A. 57 (1936) directed the trustee to pay the income to the wife and to invade corpus if necessary for her "reasonable needs." Separating these duties, the Board saw "no reason to say that the further power of the trustee serves to change or becloud the character of the distribution so as to attract the doctrine of the *Pardee* case," and permitted deduction. *Id.* at 59.

21. INT. REV. CODE § 3801(b)(4) (1939) and U. S. Treas. Reg. 103 § 19.3801(b)-4 make special provision for mitigation of limitation where the *Whitehouse* distinction was not observed. See Maguire, Surrey and Traynor, *Section 820 of the Revenue Act of 1938* (1939) 48 YALE L. J. 509, 719, 760, n. 157.

22. Had *Irwin v. Gavit*, 268 U. S. 161 (1925) exempted the income beneficiary, that income might have gone tax-free for the Revenue Act of 1913 apparently did not there tax the trustee. Brief of Respondent, *id.* at 165, citing *Smietanka v. First Trust & Savings Bank*, 257 U. S. 602 (1922). This compelling reason for the decision is no longer present. INT. REV. CODE § 162(b) (1939); *cf.* *Helvering v. Pardee*, 290 U. S. 365 (1933).

23. For comprehensive discussion, see SIMONS, *PERSONAL INCOME TAXATION* (1938) 125-147; PAUL, *SELECTED STUDIES IN FEDERAL TAXATION* (2d Series, 1938) 311.

24. Where there are several annuitants and income is insufficient to provide for them, problems of allocation arise. In the absence of specific directions in the instrument, pro rata distribution offers the most equitable solution.

that they comprise distributable income, and exempted to the extent that they come from corpus.<sup>25</sup> Because taxation of the beneficiary is thus limited to income from the trust, this solution intrudes no more upon the exemption of bequests than did *Irwin v. Gavit*. While it may be "an anomaly to tax the recipients for one year and exempt them for another simply because the executors paid the first from income received and the second out of corpus,"<sup>26</sup> this treatment has been adopted in at least one state.<sup>27</sup> The anomaly can certainly be no greater than that fostered by *Burnet v. Whitehouse*.

---

25. A present change in the rule, however, might defeat the intent of testators and settlors who drew instruments with *Burnet v. Whitehouse* in mind.

26. *Burnet v. Whitehouse*, 283 U. S. 148, 151 (1931).

27. See *Staples v. Comm'r of Corporations and Taxation*, 24 N.E. (2d) 641, 643 (Sup. J. Ct. Mass. 1940).